SEMOpx Price Control 2019-2022

Response to Consultation Paper SEM-19-063

by
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1. Executive Summary

SONI Ltd and EirGrid plc are the designated Nominated Electricity Market Operators (**NEMOs**) for Northern Ireland and Ireland respectively. SONI Ltd and EirGrid plc, working together through a Contractual Joint Venture, SEMOpx[1], welcome the opportunity to respond to the SEM Committee's Price Control Consultation Paper SEM-19-063, (the '**Consultation Paper**') as issued by the Commission for Regulation of Utilities and the Utility Regulator (the '**Regulatory Authorities'**, '**RAs**') on 12 November 2019.

In its revenue control submission SEMOpx set out its best estimate of the revenue requirement for the provision of a power exchange, including day-ahead market, intraday auction and intraday continuous services, for the wholesale Single Electricity Market (**SEM**) for the island of Ireland over the period 3 October 2019 to 2 October 2022 inclusive.

It must be recognised that given the limited operational period in, and that the SEM market is still in the early phase of establishment, there is a limit to the potential for efficiencies to be extracted. The regulatory model must continue to provide sufficient revenue to operate the business securely and efficiently and to provide appropriate incentives for its effective management in the interests of the market.

SEMOpx welcomes that the majority of the proposals put forward in the SEMOpx Submission are reflected in the framework proposed by the RAs in the Consultation Paper. There are, however, some specific areas where further consideration is required in the development of the final Price Control decision.

Specifically:

- The RA proposed margin of 2.5% is not evidentially based or justified and has not been benchmarked or considered from an overall financeability perspective. In this response SEMOpx sets out why a minimum margin of 5% is appropriate and may need to be further uplifted given the risk profile accorded through the RAs' proposals within the consultation paper;
- SEMOpx has a number of concerns with the proposed single ex-ante allowance, against a point estimate baseline figure proposals. The RAs proposal to progress this option while acknowledging the "difficulty in assessing these project estimates against any benchmarks" and where SEMOpx has clearly set out the costs are estimates of yet to be fully scoped and costed initiatives is not practicable;
- The proposed KPIs do not provide sufficient upside to enable the expenditure of discretionary capital to achieve them. As a result the reputational risks for the SEMOpx business are increased through these proposals. SEMOpx is therefore not in a position to accept that KPIs on the basis outlined be included in the proposed framework; and
- In regard to Opex the proposed reduction in the headcount will severely impact SEMOpx in its ability to continue to carry out its functions to the levels of service expected, and that the

[1] In this document the name '**SEMOpx**' is used as shorthand for EirGrid plc and SONI Ltd in their respective capacities as designated NEMOs.

internal headcount of 12.25 FTEs that was set out in the SEMOpx Submission should be provided for. This applies equally to other areas where limited evidence or justification has been provided by the RAs for that proposed.

The overall impact of the RAs' proposals would be to move SEMOpx away from undertaking activities that will deliver optimised day-ahead and intraday markets and result in a diluted focus on the delivery of core tasks only. This is a legitimate choice, but it is in our view the wrong choice and will ultimately result in significant value being lost to market participants. It is SEMOpx's view that the benefits of doing this clearly outweigh the costs of doing so. SEMOpx sets out below some of the implications of the RAs' proposed decisions in this regard. The RAs must come to a final position cognisant that they do so signing up to and accepting these implications.

	Objective	**Feasibility**	
		SEMOpx Submission (Opex + Capex)	**RA Proposal (Opex + Capex)**
Compliance-led operation of SEMOpx	Deliver CACM-derived NEMO tasks	Y	Y
	Oversee the functioning of the day-ahead and intraday trading platforms	Y	Y
	Chair (and provide administrative duties associated with) the SEMOpx Exchange Committee	Y	Y
	Core compliance obligations	Y	Y
Service Led operation of SEMOpx	Address queries from market participants in a timely and comprehensive manner	Y	N
	Continuously review and optimise internal processes and procedures	Y	N
	Ensure that existing and prospective SEM traders can easily access relevant material (e.g. training tools and online market information)	Y	N
	Proactively engage with customers to identify potential improvements to the day-ahead and intraday arrangements in SEM	Y	N
	Implement improvements to the day ahead and intraday products in response to market needs	Y	N
	Efficient quality assurance of compliance obligations	Y	N

Table 1: Feasibility of SEMOpx objectives

2. Assumptions

SEMOpx has summarised below the key assumptions underpinning the SEMOpx Submission and this response paper.

- The price control is provided on a combined basis between EirGrid and SONI on a 75% to 25% basis respectively.
- The SEMOpx Submission and the responses in this paper are premised on the assumption of continued NEMO operation on the Island of Ireland for the duration of the price control.
- This price control underwrites the continuing efficient costs of providing a NEMO service for the designation period, irrespective of SEMOpx's market share or additional costs associated with price floors for minimum volumes in each of the day ahead and intraday auctions.
- Where costs escalate either individually or in aggregate over the period of the price control above a material threshold of €0.250m due to any of changes in legislation or regulation, major or exceptional market changes, a reopener to the price control will be carried out by the SEM Committee.
- Any incremental costs imposed on SEMOpx that can be directly attributable to a Participant, for example shipping costs charged to ICOs, should be incurred by the party imposing such costs and SEMOpx should be held cost neutral from such requests, i.e. such costs would be treated as a pass-through cost.
- As set out in SEM-19-019 the Price Control will apply to SEMOpx for a period of three years regardless of whether competition arises in the market during this time.
- Capital expenditure will be depreciated over five years as part of a Regulatory Asset Base, with a return provided against a blended WACC set by reference to the prevailing regulatory approved EirGrid TSO and SONI TSO WACC rates. The recovery of the balance of any RAB at the end of the designation period will be decided by the RAs based on market conditions at the end of the designation period.
- Where revenue recovered in any given tariff period is in excess of or less than the regulatory approved revenues for that period any over or under recovery will be managed via a K-factor in future tariff periods. SEMOpx notes that treatment of any K-factor at the end of the designation period is not specified in the consultation rather the RA's set out potential options for their recovery.
- Exchange rate effects will be treated on a pass-through basis.
- Volume based fees, greater than forecast or that do not meet the fixed costs (i.e. lower than the floor in the respective contracts) which form part of the contracted services and market coupling costs will be treated on a pass-through basis.
- External legal input for significant issues such as major disputes will be treated on a pass-through basis.
- Indexation will be applied consistent with the SEMO Price Control, based on RPI and CPI in order to correct SEMOpx's revenue year by year based on the outturn rate of inflation.

Should there be any difference of understanding of the underpinning assumptions between SEMOpx and the RAs we would ask that the RAs raise such items as a matter of urgency as any change to the above has the potentially to notably impact on SEMOpx ability to deliver NEMO services.

3. Margin

SEMOpx welcomes the RAs' agreement that an appropriate level of margin is required under this revenue control. SEMOpx believes the proposed margin of 5% as set out in the SEMOpx Submission provides a competitively priced framework to meet the current and future needs of the market participants, whilst ensuring high service quality, benefit to the final consumer and increased social welfare.

3.1 Margin Rationale

We welcome the RA's acknowledgement that SEMOpx is subject to a number of unique risks that must be actively managed and reported to the competent Regulatory Authorities and that appropriate risk cover must ensue. It is our view that the margin must also reflect the annual expenditure (Opex and Capex) and reflect the services that we offer to the SEM.

In determining an appropriate margin the risks to both the SEMOpx business and the wider risks to the SEM need to be considered and carefully balanced. The nature of business activities that are undertaken by SEMOpx come with significant potential exposure, both to SEMOpx and wider stakeholders in the SEM. These risks, which are documented in Figure 1 below, are largely unrelated to our very modest asset base. The RAs' draft proposals have further increased a number of these risks / exposures from that set out in the SEMOpx Submission, this would suggest *ceteris paribus* the requirement for a higher margin than the original 5% proposed.

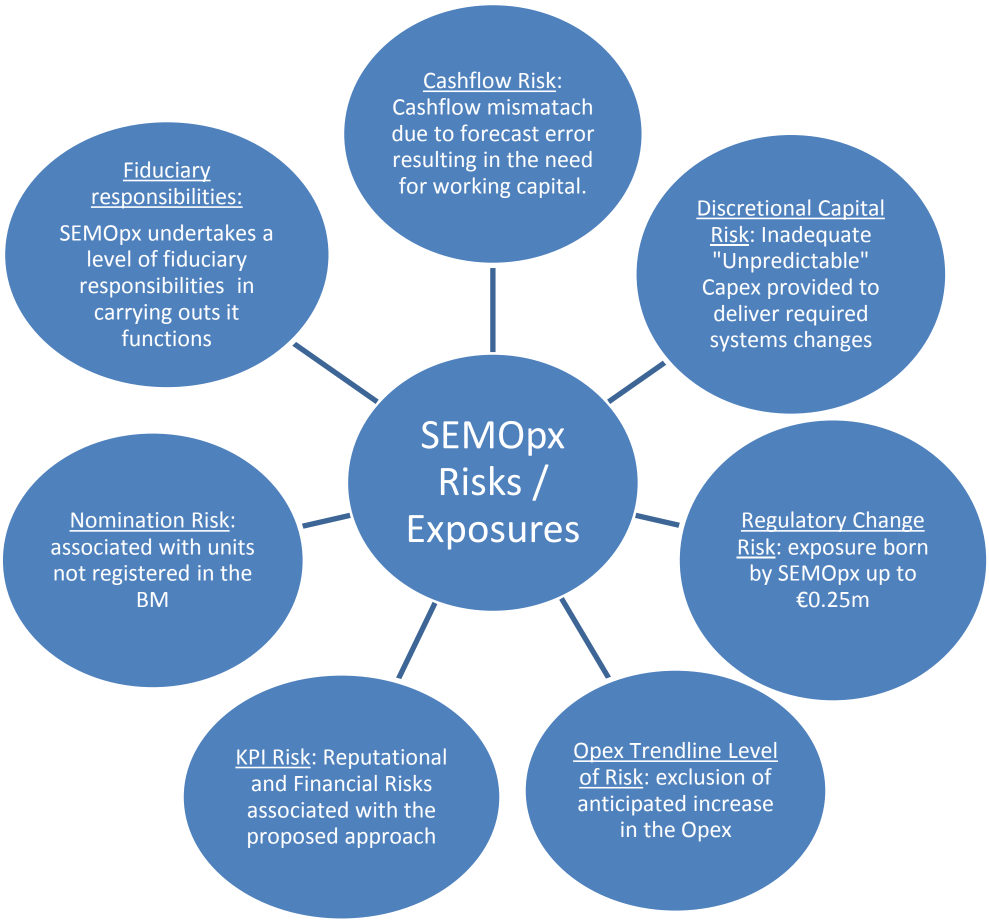

Figure 1: SEMOpx risks

In reviewing their core activities, SONI Ltd and EirGrid plc commissioned KPMG to provide an objective challenge regarding the most appropriate remuneration framework, given the fundamental characteristics of the companies. This was designed to help ensure that the risks, and therefore the associated operating margins, are considered as part of this, so as to ultimately deliver a well-calibrated benefit-sharing package. Using the methodology applied by rating agency Moody's, an EBIT margin of 10-15% on controllable costs was the minimum required to achieve an investment credit rating for an asset-light organisation such as SEMOpx. This overall benchmarked approach has been endorsed elsewhere by CRU and, following the determination of the Competition & Markets Authority, by the UR in the RAs' establishment of TSO and MO price controls.

3.2 Margin Comparison – EU Power Exchanges

Whilst SEMOpx acknowledges that it is difficult to obtain definitive benchmarking information on comparable entities, the following metrics were obtained from review of other comparable European entities of comparable status against which the SEMOpx margin should be considered. When considered alongside the aforementioned KPMG analysis, the EBIT percentage margins detailed in Table 2 reinforce our view that 5% represents the bare minimum margin which should be applied.

	Nordpool 2018 %	Nordpool 2017 %	EEX 2018 %	EEX 2017 %	EXAA 2018 %	EXAA 2017 %
EBITDA %	25%	13%	29%	28%	7%	9%
EBIT %	27%	16%	36%	35%	8%	11%
Net profit margin %	16%	11%	26%	26%	6%	8%

	GME 2018 %	GME 2017 %	PXE 2017 %	PXE 2016 %	HeNex 2018 %	HUPX 2017 %	HUPX 2016 %
EBITDA %	31%	27%	21%	13%	39%	16%	22%
EBIT %	34%	33%	21%	13%	41%	16%	22%
Net profit margin %	27%	28%	14%	9%	4%	11%	0

Table 2: Comparison of profit margins reported by European power exchanges

Overall the 2.5% margin on controllable costs as proposed by the RAs is not evidence based, unjustified and does not appear to have been benchmarked. It cannot and does not represent an acceptable overall framework for the operation of the SEMOpx business. It must be amended in the final determination.

4. Capital Expenditure (Capex)

In the SEMOpx Submission we outlined a distinction between the two types of Capex allowance that we foresee in the 2019-2022 period:

- ‘Predictable’ Business Capex allowances which enable SEMOpx to plan for hardware and software upgrades, and enhance the service provided to participants and implementation of additional operational support systems as and when the need arises;
- ‘Unpredictable’ Business Capex, which is a discretionary fund to cover the aggregate of generally smaller scale but ongoing ‘business as usual’ Capex, that enables SEMOpx to deal with unforeseen capital requirements which may/will arise in the course of any PC.

SEMOpx welcomes the RAs’ minded-to position to include the requested Unpredictable Capex provision in the Price Control and to allocate it on a pass-through basis with only actual expenditure being placed on the SEMOpx RAB.

In regard to the Predictable Capex framework however, SEMOpx has a number of concerns. While SEMOpx supports the RAs’ suggestion that the list of progressed Capex projects should be considered as a holistic package rather than discrete initiatives, we would welcome further consideration of the proposed basis for setting the Capex provision and its incentivisation.

4.1 Capex Incentivisation

SEMOpx understands the RAs’ efforts to introduce a mechanism to ensure that SEMOpx drives value for money in the delivery of its Capex initiatives. The RAs propose two approaches – a single ex-ante allowance, leading to a reward or penalty based on performance against that allowance, or a menu regulation, whereby the ultimate reward or penalty is derived from the package of projects pursued by SEMOpx. SEMOpx agrees with the assertion of the RAs that the “smaller scale of the proposed Capex allowance under this price control may not necessitate the complexity of (menu regulation)”.

Concerning the proposed single ex-ante allowance, we would expect any potential risk (or reward) framework to recognise the capital employed to undertake a given activity. It is a concern that the RAs propose to progress this option against “*a baseline of 95% applied to cost estimates provided by SEMOpx to account for any efficiencies*”, having acknowledged the “*difficulty in assessing these project estimates against any benchmarks*”.

As outlined in the SEMOpx Submission, and as acknowledged by the RAs in their Consultation Paper, the quoted costs of the Capex projects are a provisional estimate and, therefore, are subject to change. Despite the challenges in quantifying these initiatives, we included these estimates in order to help inform the SEMOpx tariff setting.

A single ex-ante allowance can only be effectively implemented under one of two scenarios.

(1) The first would be against a reference price derived from empirical evidence. This is a core principle when considering SEMOpx’s possible liabilities as a result of the RAs’ proposed Capex Incentivisation mechanism; in the absence of a transparently-developed target cost, the quantification of the prospective risk against the entity’s balance sheet places an unequitable risk on to SEMOpx. However, both SEMOpx in its submission and the RAs in the

Consultation Paper recognise that is very difficult to do at this point, where projects are yet to be fully scoped and costed.

(2) Alternatively, in the absence of a single evidence-based reference price, a "deadband" cost range should be determined to sit within the cap-and-collar-based cost envelope that is proposed by the RAs. The penalty and reward framework would then exist outside of the "deadband" with SEMOpx incurring a penalty where outturn costs exceed the upper bound of the deadband up to the Cap or where efficiencies are achieved and costs outrun less than the lower bound down to the collar (floor) a reward related to these efficiencies would ensue.

SEMOpx supports the principle of the 50% penalty or reward share, whereby SEMOpx would be incentivised to under spend this allowance by retaining 50% of savings derived from efficiency gains, with 50% of any over expenditure being absorbed by SEMOpx.

The RAs proposed Monitoring Framework provides a governance framework through which to approve project removal or project substitution as more detailed status updates including project scope, expected costs and market benefits become available.

Ultimately there is a link between the final Capex incentivisation scheme and the determination of the margin for SEMOpx. Margins are discussed further in Section 3.

4.2 Capex Projects

It is the view of SEMOpx that all the projects identified, whether categorised as 'discretionary' or 'mandatory', will add value to the SEM trading community and should be considered as a holistic package[2], rather than discreet initiatives to be delivered independently. In that context, we support the RAs' proposal whereby a single, overall Predictable Capex allowance is approved, rather than isolating individual project allowances.

However we note the significant reduction in the proposed allowance for Product Development. SEMOpx's overarching objective is to assist participants in achieving their electricity trading objectives. As part of this commitment, we would expect to continue to engage with current, and prospective, market participants to ensure that the day-ahead and intraday trading products are optimised so as to increase market liquidity. We envisage that this engagement could lead to changes to our current systems infrastructure and would be keen to ensure that a lack of funding in this area does not serve to prevent the implementation of any improvements. It is, therefore, the view of SEMOpx that the RAs should reconsider the approach to allow €100,000 per annum for Product Development and to allocate additional revenues to the overall Predictable Capex allowance to enable this.

Overall however, as it stands the proposed KPIs do not provide sufficient upside to enable the expenditure of discretionary capital to achieve them. As a result the reputational risks for the SEMOpx business are increased through these proposals. SEMOpx is therefore not in a position to accept that KPIs on the basis outlined be included in the proposed framework.

[2] We would note separate correspondence dated 09 December regarding Effective dating in ETS & Intraday Auctions Inclusion of Complex Orders in this context.

5. Key Performance Indicators (KPIs)

SEMOpx is of the view that the proposed reward framework is insufficient to ensure the incentives are meaningful and to enable SEMOpx to invest discretionary capital to enable their achievement. As a result the proposed arrangements increase either or both the financial and reputational risk on SEMOpx without providing a mechanism to enable their delivery.

It is the relationship between the KPIs and the potential impact on services to customers that should set the basis for the scale of incentive entitlement and not simply the relative number of incentives. Therefore, SEMOpx maintains that the €200,000 incentive outlined in the SEMOpx Submission represents a proportionate incentive to the value offered to our customers. Further SEMOpx believes that the incentive targets for a number of the proposals as set out in the Consultation Paper need to be reconsidered in the context of the volumes of activity associated with the respective KPIs to ensure appropriate behaviours are incentivised and targets are not seen to be unattainable from the outset.

5.1 KPI Incentivisation

The RAs propose that the potential KPI entitlement is set to 2% of internal Opex to reflect the smaller number of KPIs in comparison to those currently applied to SEMO. However, it is the relationship between the KPIs and the potential impact on services to customer that should set the basis for the scale of incentive entitlement and not simply the relative number of incentives.

SEMOpx executes trades for 85% of the total value of trade in the SEM (estimated at some €2.5 billion per annum) and, due to the RA-approved market design, demand in the SEM needs to be traded through the ex-ante markets. This would indicate the importance of the SEMOpx services in the efficient and effective operation of the SEM; we would expect this to be reflected in the incentive framework available through the KPI mechanism.

Prior to submitting the SEMOpx Submission we engaged extensively with market participants with a view to understanding the areas of our business which have the biggest impact on their ability to trade in the SEM. We believe that we have appropriately reflected this in our proposed three KPIs and understand the value that high performance in each of these areas brings to SEM.

It is the view of SEMOpx that providing only 2% of internal Opex by way of a KPI incentive does not reflect the activity, and performance standards, that market participants expect of SEMOpx in its role within SEM. SEMOpx retains the view that the original proposal in the SEMOpx Submission of €200,000 is a fair reflection of the incentive opportunity that should be made available to SEMOpx in its delivery of these key activities.

5.2 Proposed KPIs

The RAs' support for the proposals and definitions for KPIs related to Auction Results, System Availability and General Queries is welcomed and we note the proposed amendments to the definitions and targets associated with two of these three indicators. As part of the RAs' considerations of appropriate success criteria for SEMOpx, we wish to ensure that the volume of activity undertaken in each field is clearly and commonly understood.

Auction Results KPI

When considering Auction Results, it should be noted that 124 auctions run within a calendar month. This means that setting a lower bound of 99.0% would result in a single late publication rendering the incentive unachievable in a given month. SEMOpx believe an allowance of two late reports out of the total 124 auctions run per month would be more appropriate and realistic as a lower bound. This would equate to a lower bound percentage of 98.0%. Having such a lower bound of 98.0% will still incentives SEMOpx to strive to meet the publication criteria even if 1 or possibly 2 publications were more than an hour late in any given month.

General Queries KPI

When reviewing our performance against the proposed General Queries KPI, we note that, at present, on average 89.2% of queries are resolved within the 20 business days proposed by the RAs for this KPI. Setting a target with a lower bound of 95% therefore would be a significant stretch to achieve given historical trends. Moreover given the relatively small scale of queries received increasing the lower bound to 95% would result in a single missed query target rendering the incentive unachievable. SEMOpx believe a lower bound that allows for two longer running queries per month would be more appropriate and realistic as a lower bound. This would equate to a lower bound percentage of 93%. Having such a lower bound of 93% would still incentive SEMOpx to strive to meet the query resolution criteria even if one, or two, queries were taking longer in any given month.

5.3 Measurement & Reporting

In addition to setting an appropriate target for each of the KPIs, to ensure that the SEMOpx KPIs are implementable and are measured on a consistent and commonly understood basis SEMOpx requests that the RAs confirm in their final determination the following:

- In terms of each of the incentives, External Factors which are demonstrably outside of SEMOpx's direct control are excluded from the KPI measurements; such as:
    - SEMO and/or System Operator system failures and issues outside of SEMOpx's control; and
    - Planned outages, Planned Releases and ad-hoc releases that have an impact.
- In regard to General Queries,
    - Queries unresolved for more than 20 business days are only counted once and not on a rolling basis
    - If further information is requested following resolution of a query this is counted as a new query
    - If information required is dependent on third parties and is outside of SEMOpx's control this does not impact on the calculation of the metric.

SEMOpx proposes that it reports on its performance against the incentives as part of the annual K-factor and tariff setting process for SEMOpx. Such a report would include details of any adjustments made as result of the factors noted above, should they arise.

6. Operating Expenditure (Opex)

SEMOpx notes the RAs' proposed treatment of the Opex outlined in the SEMOpx Submission. Whilst we remain committed to ensuring that our activities are conducted in a prudent and efficient way, we do not consider that the RAs' approach reflect the costs associated with running the power exchange, including DAM, IDA and IDC services, for the wholesale Single Electricity Market, including adding additional value to Market Participants through enhanced service value.

6.1 FTE Allocation

SEMOpx believes the 12.25 internal FTE resource required as set out in the SEMOpx Submission is justified as it is based on the clearly defined business needs. Setting aside the 2 trading operations resources which were, as communicated in the SEMOpx Submission, omitted from the 2018/2019 price control (but for which SEMOpx managed temporarily within the overall budget for 2018/2019 by deprioritising certain customer service and market development work), there is actually a reduction in head count of ~0.5 FTE from 10.65 in the 2018/2019 approved allowance to 10.25 in the 2019-2022 submission.

As stated in the SEMOpx Submission, SEMOpx has performed a review of the resource requirements against obligations under the NEMO obligations and ex-ante market rules, as well as consideration of the actual outturn of resources requirements from the initial months of operation of the SEM. The result of this review was to identify and propose a reduction in the legal resource requirement of 0.5 of an FTE based on actual outturn requirements.

The RAs in the Consultation Paper proposed a reduction in the FTE provision from 12.25 to 11.5 for the duration of the price control. This proposal is premised on the RAs' view that efficiencies should exist between the new market setup and the enduring resource requirements for registration of new participants, negotiation of contracts, and vendor management. SEMOpx believes that this proposal will hamper SEMOpx's ability to meet its obligations and potentially cause deterioration of service provision.

In the specific case of registrations, the workload is dependent on a number of factors including, the number of member applications, the volume of unit additions to the market, the volume of change of ownership or change of trading responsibility for units, the number of changes to trader personnel and logins required for the trading systems, etc..

Given the foreseen pipeline of new unit connections and the anticipated change of registrations relating to ex-ante trading as a result of competition for supplying of ex-ante trading services by market participants, SEMOpx do not see evidence of a drop off in workload of registrations occurring, in fact it appears that workload will increase over time. As examples of the volumes foreseen:

- SEMOpx's has seen 11 additional members join in the first year of operation and is continuing to see additional membership applications. Currently, there are 6 further applications in progress.
- As specified in the SEMOpx Submission to the RAs, we are expecting a large amount of activity in the registration of units over the coming years, which will mean the workload in

registration is likely to increase, not decrease overtime. For example, there are in the order of 29 new windfarms looking to be connected to the grid over the next few years, and based on capacity auctions there are potentially 125 new units entering the SEM during the same period. In addition, we have seen high demand for the transfer of units between traders due to either changes in PPA agreements (23 so far this year), or competition between trading service providers (8 currently in progress).

As a snapshot, at present there are 8 new Generation Units, 7 Supplier Units, 3 Assetless Units, 1 Demand Side Unit and 9 change of ownership and 3 de-registrations being processed. The effort required to process these registrations should not be underestimated. Registration is very complex part of the SEMOpx operations as it involves multiple parties (SEMOpx registration, ECC, EPEX, SEMO), and multiple systems (ETS, M7, MMS, OUI, MDP systems and TSO systems). The overlapping of trading timeframes means the setup in systems is also a time critical activity. This means that having adequate registration resources is crucial to the effective operations.

Registration has been identified historically as the cause of the majority of issues related to the market operations due to the complexities of coordinating system setup across multiple systems and co-ordination with multiple parties (in the case of the revised SEM arrangements this is accentuated further with the multiple market timeframes). All the above indicates that the registration resource proposed in the SEMOpx Submission will be fully utilised even with efficiencies occurring.

In the specific area of negotiation of contracts cited by the RAs, SEMOpx has already accounted for efficiencies in this area by identifying a 0.5 FTE head count reduction in the legal resource area based on evidence from the first year of operation and a look ahead to the expected operational workload in the years going forward. However there continues to be significant work in maintaining and reviewing these contracts as the European coupled, regional coupled and local SEM markets develop.

In terms of benchmarking the FTE numbers against similar business, the RAs cite HUPX as an example. In this comparison the RAs acknowledge that the SEMOpx resource numbers of 14.25 compare favourably with the 29 employees of HUPX, providing a further indication that SEMOpx’s estimates of resources are reasonable. In addition, SEMOpx’s overall costs and trading fees are lower than HUPX, adding further weight to the efficiency of SEMOpx’s operations.

Although the difference may seem small between the proposed headcount and SEMOpx’s request, given the small team size the consequences of under resourcing SEMOpx will have considerable impacts on the quality of the operations, query response times, levels of customer service, service levels of the service providers and the likelihood of errors or omissions – which can have considerable financial impacts on participants through missed trading opportunities. SEMOpx do not believe the reduction in resources to 11.5 internal FTEs is practicable.

6.2 Overhead Costs

SEMOpx welcomes the RAs acknowledgement that not all Overhead cost categories are driven by FTE numbers as some are fixed costs (such as insurance) and that an increase in such fixed costs categories drives an increase in the average overhead rate per FTE.

As set out by the RAs in Section 2.3.3 of the Consultation Paper if only the overhead costs which are FTE driven are compared, the overhead rate per FTE is comparable to SEM-17-096.

As a result SEMOpx does not believe that the broad brush proposal to reduce the overhead provision to make the figure match that provided for in the previous price control period and indeed that in the separate regulated decision for the MOs is justified. While benchmarking to previous or broadly analogous businesses can provide a framework of the consideration of costs, it should not be used an absolute reference marker and the individual characteristics of each entity must be taken into consideration. In terms of SEMOpx the key driver for the increase in overhead costs is the fixed cost of insurance for the SEMOpx business.

6.2.1 Insurance costs

The EirGrid Group retains AON as its independent insurance brokers and advisers. In procuring insurance for SEMOpx AON engaged with the industry negotiating with underwriters in both the Irish and London markets. Aon compiled an independent assessment of the available insurance covers and advised on the most appropriate policy to meet SEMOpx's requirements. The costs as set out in the SEMOpx Submission are reflective of this type of insurance and the current insurance market conditions which is experiencing hardening rates and capacity issues.

As the insurance costs are based on the outcome of an independent and competitive process, their inclusion in the Overhead costs is appropriate. As recognised by the RAs the increase in such a fixed cost will result in an increase in the average overhead rate per FTE and as such a disallowance by reference to 'average' overhead costs as included in SEM-17-096 should be reversed in the final decision.

6.3 Finance and Regulation

6.3.1 Market Audit Costs

SEMOpx acknowledges the confirmation from the RAs that there will be no Market Audit specifically for SEMOpx and notes that the revenues initially included by SEMOpx for same are thus not required. Should the RAs' position in this regard change over the course of the price control SEMOpx note that an appropriate adjustment for the associated costs would need to be provided for as part of the annual adjustment and tariff process.

6.3.2 Audit Fees

Audit services are procured via a competitive tender. To extract best value from the market such services are typically procured on a multi-year basis. The basis for the SEMOpx tender is a 3 year term with the option to extend for a further 3 year period. These audit services do not generally include a reducing scale audit cost over time given their relatively short duration. As a result it is not reflective of the underpinning procurement arrangements to assume that the Audit fees would reduce over the course of the price control period.

Audits serve an important role for companies in ensuring best practice governance, financial management, oversight, and reporting. Recurring analysis of a company's operations and maintaining rigorous systems of internal controls can prevent and detect issues, raise recommendations for improvement and provide confidence to stakeholders. SEMOpx executes trades for 85% of the total value of trade in the SEM, estimated at some €2.5 billion per annum. Given the scale of monies being managed by SEMOpx, and in order to enable the directors fulfil their fiduciary responsibilities and to provide market participants and the RAs with confidence in the execution of our key activities (as well as noting that that SEMOpx is not subject to any regulatory audits), it is essential that SEMOpx has sufficient revenues in place to enable high-quality audits to be undertaken.

6.3.3 Legal Professional Fees

SEMOpx has included in the SEMOpx Submission its view of a prudent level of potential Legal Professional fees for the Price Control period. The estimate reflects only a basic coverage for minor external legal counsel. It does not countenance any external legal input for significant issues such as major disputes which are difficult to forecast, by reference to recent disputes under the T&SC a single major dispute would likely drive significant legal costs that greatly outstrip the current estimates. In addition, the forecast does not provide for any significant external legal advises that may be driven to changes in the market arrangements and in turn arrangements with our Service Providers.

6.4 Contract Services and Market Coupling

SEMOpx welcomes the RAs' proposal on the recovery of contracted services and market coupling costs, and confirmation from the RAs that the volume based fees, which form part of the contacted services, will be recoverable on a pass-through basis. That is, if volumes are higher than estimated in the price control then the additional volume related costs for the contracted services would be allowed as a direct pass-through and SEMOpx will be allowed to retain the necessary revenue from the additional volume fees to meet the volume based contracted service costs.

SEMOpx would ask that the RAs include clarification in their final decision to make it clear that these volume based costs will be allowed as a direct pass-through.

7. Conclusion

The overall impact of the RAs' proposals would be to move SEMOpx away from undertaking activities that will deliver optimised day-ahead and intraday markets and result in a diluted focus on the delivery of core tasks only. This is a legitimate choice, but it is in our view the wrong choice and will ultimately result in significant value being lost to market participants. It is SEMOpx's view that the benefits of doing this clearly outweigh the costs of doing so. SEMOpx sets out below some of the implications of the RAs' proposed decisions in this regard. The RAs must come to a final position cognisant that they do so signing up to and accepting these implications.

	Objective	Feasibility	
		SEMOpx Submission (Opex + Capex)	**RA Proposal (Opex + Capex)**
Compliance-led operation of SEMOpx	Deliver CACM-derived NEMO tasks	Y	Y
	Oversee the functioning of the day-ahead and intraday trading platforms	Y	Y
	Chair (and provide administrative duties associated with) the SEMOpx Exchange Committee	Y	Y
	Core compliance obligations	Y	Y
Service Led operation of SEMOpx	Address queries from market participants in a timely and comprehensive manner	Y	N
	Continuously review and optimise internal processes and procedures	Y	N
	Ensure that existing and prospective SEM traders can easily access relevant material (e.g. training tools and online market information)	Y	N
	Proactively engage with customers to identify potential improvements to the day-ahead and intraday arrangements in SEM	Y	N
	Implement improvements to the day ahead and intraday products in response to market needs	Y	N
	Efficient quality assurance of compliance obligations	Y	N

Table 3: Feasibility of SEMOpx objectives

Appendix 1

Clarification on Capex Figures in Consultation Paper

For completeness SEMOpx wishes to highlight that in Table 2 of the Consultation Paper the Capex Summary figures for the SEMOpx Submission are incorrectly represented. The SEMOpx Submission numbers are correctly stated in Section 3 of the Consultation Paper and the narrative is not impacted by this summary table.

As set out in Table 3 of the SEMOpx Submission the Capex requirement sought was €774,000 for 2019/20, €869,000 for 2020/21 and €525,000 for 2021/22. For the avoidance of doubt, each of these three figures is inclusive of the Unpredictable Capex figure of €50,000 per year. As a result Table 2 in the Consultation Paper should have read as below.

	SEMOpx Submission				RA Proposal			
March 2019 Prices	**2019/2020**	**2020/2021**	**2021/2022**	**Total**	**2019/2020**	**2020/2021**	**2021/2022**	**Total**
Unpredicatable Capex Submission	50,000	50,000	50,000	150,000	50,000	50,000	50,000	150,000
Predicatable Capex Submission	724,000	819,000	475,000	2,018,000	546,250	669,750	356,250	1,572,250
Total Capex	**774,000**	**869,000**	**525,000**	**2,168,000**	**596,250**	**719,750**	**406,250**	**1,722,250**

Table 4: Corrected Capex cost figures