

Trading and Settlement Code Modifications Committee
C/O Sherine King
SMO Modifications Committee Secretariat
The Oval, 160 Shelbourne Rd
Dublin 4

5 July 2012

Our Ref: D/12/8352

**SEM Committee Decision for the Regulatory Authorities in relation to Mod_16_11
(Recommendation Report FRR_16_11)**

Dear Sherine,

On 27th February 2012, the Modifications Committee submitted its Modification Recommendation Report with regard to a Modification Proposal, Mod_16_11 (Credit Worthiness Test for SEM Bank and Credit Cover Provider Banks), in accordance with paragraph 2.213 of the SEM Trading and Settlement Code (the Code).

This Modification Proposal was raised by NIE Energy PPB (original and version 2) and by Bord Gáis Energy (version 3) who sought to amend the criteria which the Code requires shall be met by the SEM Bank and the criteria that shall be met by any Credit Cover Provider in SEM. The reasons for raising the Modification Proposal by NIE Energy PPB included, amongst other things, the time lag associated with the publication of financial statements and the potential problems associated with using Total Balance Sheet Assets as opposed to Net Assets.

The SEM Committee notes that the Modifications Committee agreed by majority vote to reject version 2 of the Modification Proposal and by a split vote, which was passed by a casting vote, to recommend version 3 of the Modification Proposal for approval. As such, the Modifications Committee found it difficult to agree a common recommendation to the SEM Committee.

The Modification Committee's report states that the recommended version of the Modification Proposal furthers the Code Objectives "to facilitate the efficient, economic and coordinated operation, administration and development of the Single Electricity Market in a financially secure manner", "to facilitate the participation of electricity undertakings engaged in generation, supply or sale of electricity in the trading arrangements under the Single Electricity Market", "to promote competition in the in the single electricity wholesale market on the island of Ireland", "to ensure no undue discrimination between persons who are parties to the Code" and "to promote the short-term and long-term interests of consumers of electricity on the island of Ireland with respect to price, quality, reliability and security of supply of electricity". In addition the Modifications Committee recommended that the Modification should be implemented on a Settlement day basis on 1st November 2012, in order to align with the timescales for the appointment by the Market Operator of the new SEM Bank. In subsequent discussions SEMO has recommended that the implementation date should be 1st April 2013. This is because the 1st November 2012 recommended date was based on a SEMC Decision coming earlier than June 2012.

The SEM Committee further notes that the Modification Proposal was extensively debated by the Modifications Committee and its working groups. The SEM Committee notes that there is agreement within the Modifications Committee on the broadening of the jurisdictional requirements and the use of Net Asset Value as opposed to the currently employed Total Balance Sheet Asset Value. The SEM Committee sees the merit in approving these changes in the Code which should increase the number of banks that are eligible to act as the SEM Bank or to provide letters of credit in the SEM.

The difference between versions 2 and 3 of the Modification Proposal is the question of whether the inclusion of a government bank guarantee scheme for either Ireland or UK banks should be considered to be sufficient for that bank to act as a Credit Cover Provider. The role of a Credit Cover Provider under the Code is to allow Participants to obtain Letters of Credit which can be used as part of that Participant's Required Credit Cover under the Code.


The merit of inclusion of a government bank guarantee scheme or otherwise relates to the question of whether the risk of default when a Letter of Credit is called is increased when the provider of that Letter of Credit is a bank which is included in the Irish or UK government guarantee scheme but does not comply with the other criteria for a Credit Cover Provider.

Given that governments guarantee certain domestic banks to provide confidence in their ability to continue operations, it is not clear that there is an increased risk of default by the addition of such a clause in the Code. It should also be borne in mind that the only circumstances when this issue would come into effect would be when a Participant fails to pay a bill and where SEMO has to make a call on its Credit Cover thereby requiring two very significant events to occur at the same time. In addition, it is likely that such a risk outlined above is offset by the increased availability of Credit Cover Providers that such a provision could provide.

The point was raised at the Modifications Committee that the government guarantee scheme, in Ireland at least, does not explicitly cover Letters of Credit. However, a counter argument was made that (i) the inclusion of a bank in such a government guarantee scheme is a form of statement of government confidence in the financial survival of the bank and (ii) even if Letters of Credit are not included under such a guarantee, the failure to pay a Letter of Credit on demand is a default by the bank, the result of which would be a major loss of confidence in the bank and therefore a major impact on the bank's ability to borrow and that such a step would therefore not be taken lightly.

The SEM Committee believes that version 3 of the Modification Proposal does address the concerns raised by NIE Energy PPB when proposing the original Proposal and that it is preferable to Version 2 due to the reasons set out above. Therefore, in accordance with paragraph 2.218 of the Code, the SEM Committee directs that a Modification, as set out in Appendix 3 (version 3 of Mod_16_11) of the Modifications Committee report (FRR_16_11) shall be made and shall come into effect on a Settlement Day basis on 1st May 2013.

Yours sincerely,



Sheenagh Rooney
Manager - Wholesale Electricity Market