

Trading and Settlement Code Modifications Committee
C/O Katia Compagnoni
SEMO Modifications Committee Secretariat
The Oval
160 Shelbourne Rd
Dublin 4

08 September 2016

Our Ref: D/16/122286

**SEM Committee Decision for the Regulatory Authorities in relation to Mod_02_13
(Recommendation Report FRR_02_13)**

Dear Katia,

On 2nd October 2015, the Modifications Committee submitted its Modification Recommendation Report with regard to Modification Proposal, Mod_02_13 (Registration of Charges) in accordance with paragraph 2.213 of the SEM Trading and Settlement Code (the Code).

Modification Proposal Mod_02_13 was originally raised by EirGrid legal and was stated to seek to regulate the position regarding security over Collateral Reserve Accounts. It sought to do this by removing the obligation on the Market Operator to register a charge over the Collateral Reserve Accounts. The reason for proposing this change was that a number of such unsecured accounts exist in the SEM as a result of both administrative oversights and of failure of some Participants to comply with obligations set out in the Code. Independent legal advice was sought by the Modifications Committee, which resulted in the consideration of three options.

The options were:

1. to do nothing;
2. to implement stricter enforcement and additional security around registration of charges;
3. and title transfer (in respect of cash collateral).

The initial recommendation from the "External Counsel" was that the preferred option was title transfer. The Modifications Committee reached the view that the best approach was the second option: to implement stricter enforcement and additional security around the registration of charges. This approach required the introduction of a new Deed of Charge and Account Security within the Code.

The SEM Committee notes that this proposal was debated extensively at seventeen Modification Committee meetings and a further three conference calls over a period of nearly three years and that the Modifications Committee employed "External Counsel" specifically to provide legal advice, including detailed legal drafting, on this issue. The SEM Committee also notes that one

Participant, which had been very active in the process of developing the Modification and very helpful in reviewing the legal drafting had taken the consistent view that the provisions of the Code, with simple changes “to perfect the Trust wording” as they stood were broadly satisfactory.

This same Participant required that its “dissenting comments” were included in the Modifications Committee Report. The SEM Committee takes the view that, having procured legal advice (from an “External Counsel”) specifically in relation to the issue of the security of the cash collateral accounts, the Modifications Committee took the prudent approach of relying on that advice.

The SEM Committee notes that the Modifications Committee voted by a majority to recommend the approval of this Modification Proposal and took the view that it furthered the Code Objective to “facilitate the efficient discharge by the Market Operator of the obligations imposed upon it by its Market Operator Licences”. The Modifications Committee also recommended that the Modification should be implemented on a Trading Day basis with effect from one Working Day after an RA Decision is made. The SEM Committee notes that collateral under the Code is a settlement matter and that the Modification, if implemented, should be done on a Settlement Day basis. The SEM Committee is also concerned about the implementation timescales proposed. This is addressed below.

The SEM Committee notes that there are nine “Dissenting Comments”. Each is considered in turn below and the SEM Committee view set out:

1. The drafting is “discriminatory”

This comment relates to the provision of SEM Collateral Reserve Accounts in respect of Northern Ireland Participants in London, rather than in Northern Ireland as is specified in paragraph 6.19 of the Code. The SEM Committee takes the view that this is not a matter for this Modification Proposal but for Mod_08_14 and has considered this comment in relation to its decision on that Modification Proposal.

2. “Condone a breach of the Code”

This comment also relates to the location of Collateral Reserve Accounts and is also a matter for Mod_08_14 but the SEM Committee takes the view that any alleged breach of the Code is not a matter for the Modifications Committee but for the Regulatory Authorities in their management of licence conditions requiring compliance with the Code.

3. “Condone the failure of the MO to properly administer the banking arrangements”

The SEM Committee takes the view that whether or not the Market Operator properly administered the banking arrangements in relation to the procurement of the SEM Bank is not a matter for the Modifications Committee.

4. “Introduces English law and jurisdiction into the Code”

The SEM Committee notes that this refers only to the proposed Deed of Charge and Account Security in Appendix 4 of the Code and only in relation to Collateral Reserve Accounts located in the UK and outside Northern Ireland. The SEM Committee further notes that this requirement was an essential element of the legal advice and legal drafting by the External Counsel and therefore can properly be relied upon by the Modifications Committee.

5. "This Modification is inextricably linked [to] Modification Mod_08_14 (Clarification of Location of SEM Collateral Reserve Accounts)".

The SEM Committee has noted the connection between these two Modification Proposals but does not believe that there is a dependency, which would need to influence its decision in relation to either Proposal.

6. "The Modification contains no grace period or transition periods, as such its passage without amendment will place all PTs utilising cash deposits in Default".

The SEM Committee accepts this comment and will take account of it in its decision on the implementation of the Modification Proposal.

7. "The Modification does not address 'Difficulties have arisen with regard to registering charges in jurisdictions outside the SEM'".

For assets in Dublin and London, charges have to be registered in the location of the charged asset. In relation to Participants registered outside the United Kingdom or Ireland, the inclusion of a definition for Account Security Requirements in the Code as part of this Modification will give the Market Operator powers to request any additional documents or information required to implement the necessary security requirements.

8. "The Proposed Modifications to Code".

This comment identifies four asserted defects to the legal approach proposed by the "External Counsel" and recommended by the Modifications Committee. The SEM Committee takes the view that having sought specific legal advice, the Modifications Committee is right to rely upon it.

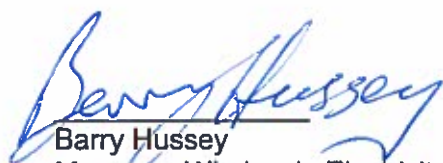
9. "The Proposed Deed of Charge and Account Security ... contains drafting defects which bring into doubt its enforceability".

This comment mentions seven specific areas of concern. However, the SEM Committee once again takes the view that the Modifications Committee is right to rely upon the legal advice of its "External Counsel".

Considering the above, the SEM Committee directs that, in line with the recommendation of the Modifications Committee in FRR_02_13, the Modification Proposal Mod_02_13, for the avoidance of doubt based upon the legal drafting in Section 9 and Appendix 1, should be made

and should be implemented on a Settlement Day basis. Having considered the comments with regard to immediate implementation, the SEM Committee directs that this Modification (Mod_02_13) should be implemented no later than six months after the date of this letter and that the Market Operator should within the next month communicate with all Participants with Collateral Reserve Accounts making them aware of the date of implementation of this Modification and of the need to enter into the Deed of Charge and Account Security and of any other actions that they need to take to be ready for the implementation of the Modification.

Yours sincerely,



Barry Hussey
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