



## **SEM COMMITTEE**

### **TRADING AND SETTLEMENT CODE**

#### **RA Modification Proposals**

## **DECISION PAPER**

**1<sup>st</sup> October 2009**

**SEM-09-099**

## 1. Background

The Single Electricity Market (SEM) Trading and Settlement Code (the Code) was designated and came into effect on 3<sup>rd</sup> July 2007, when the Framework Agreement was signed by the original signatories. Subsequently on 1<sup>st</sup> November 2007, the SEM went live.

Section 2 of the Code contains within it the mechanism by which changes may be made to the terms of the Code – the Modifications Process. This is the only process for amending the Code. The Regulatory Authorities (RAs) can use those processes to propose any change that they consider should be made to the Code. The process allows the Modifications Committee eight months to consider a Modification Proposal before a recommendation report is required to be submitted to the RAs seeking a determination in respect of that proposal.

When the Code was being developed, it was thought possible that future amendments to the Code would largely be left to Market Participants and that the RA's interest in proposing Modifications would be limited. This has been largely true to date as the RAs have proposed only 11 modifications, which is less than 6% of the total raised to date.

However, it has become clear that future regulatory developments could result in an increase in RA Modifications to the Code. These amendments to the Code are likely to be needed to implement policy decisions which have a wide scope and regulatory significance. Examples of such policy developments are the "Scope of CPM Medium Term Review", SEM-09-035, 8<sup>th</sup> April 2009; see also the "SEM Committee Annual Report", SEM-09-022, March 2009, and its Section 11 setting out the work-plan for the second year of the SEM.

The SEM Committee<sup>1</sup> takes the view that some change to the Code Modifications Process may be necessary to enable changes which result from important regulatory matters, and which have already been the subject of wide consultation by the RAs, to move through the Modifications Process in a more efficient manner and without requiring the Modifications Committee to duplicate processes which have already been undertaken outside the Code processes. However, the SEM Committee also takes the view that any such amendments should not limit the proper review of the Modification Proposal by the Modifications Committee nor should it by-pass the Code Modifications Process.

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<sup>1</sup> The SEM Committee is established in Ireland and Northern Ireland by virtue of section 8A of the Electricity Regulation Act 1999 as inserted by section 4 of the Electricity Regulation (Amendment) Act 2007, and Article 6 (1) of the Electricity (Single Wholesale Market) (Northern Ireland) Order 2007 respectively. The SEM Committee is a Committee of both CER and NIAUR (together the RAs) that, on behalf of the RAs, takes any decision as to the exercise of a relevant function of CER or NIAUR in relation to an SEM matter.

## 2. Code Modification Process

An outline of the SEM Trading and Settlement Code modification process is as follows:

- Any person may submit a Modification Proposal to amend the Code;
- Such proposals are required to propose changes to the Code legal drafting, but it should be noted that part of the role of the Modifications Committee (which is set out in paragraph 2.149 of the Code) is to “work up the detail” of each Modification Proposal including amending and improving the suggested legal drafting;
- Such proposals are also required to set out how the proposer believes that the Modification Proposal would better facilitate the Code Objectives;
- The Modifications Committee is obliged to consider and to develop any Modification Proposal (making use of working groups and seeking impact assessments from relevant parties as it wishes) and to decide whether it believes that the resultant Modification Proposal will better facilitate the Code Objectives;
- The Modifications Committee then prepares a Modification Recommendation Report (the contents of which is set out in paragraph 2.215 of the Code) to the RAs. Such a report is required to be submitted within 8 months<sup>2</sup> of the Modifications Proposal being raised (see paragraph 2.192);
- On receipt of the Modification Recommendation Report, the RAs (on behalf of the SEM Committee) can make one of three decisions on the Modification Proposal set out in the report:
  - Direct a modification to the Code;
  - Reject the modification proposal; or
  - Direct the Modifications Committee that further work is required.

Depending upon the complexity of and controversy about the Modification Proposal this can be a very brisk or a very slow process.

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<sup>2</sup> This period can be extended with RA consent.

### **3. Urgent Modifications**

The Code recognises that there may be circumstances where a Modification Proposal needs to be progressed in a more time efficient manner. The Code therefore designates a class of Modification Proposals as “Urgent”. These Modifications are then subject to a fast-track process. The RAs determine whether a Modification Proposal is “Urgent” or not using the Code obligation that the Modification Proposal to comply with at least one of the following criteria, set out at paragraph 2.208:

- if not made it would prejudice safety or security of supply of electricity;
- if not made it would unduly interfere with, threaten or disrupt the operation of the SEM;  
or,
- it is required to correct an obviously material error or inconsistency in the Code.

There are only two differences between the “Urgent” Modification process and the normal process. Firstly (see paragraph 2.209), the Modifications Committee is required to convene an Emergency Meeting rather than waiting for the next scheduled meeting<sup>3</sup> to consider the proposal. Secondly (see paragraph 2.211), the Modifications Committee is required to propose the procedure and timetable to be followed in making a recommendation in respect of the Urgent Modification, which the RAs may veto or amend.

This means that an Urgent Modification is likely to be dealt with by the Modifications Committee in a more time-orientated fashion than would be the case for standard Modification Proposals.

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<sup>3</sup> The Code requires that the Modifications Committee meets at least once every two months (see paragraph 2.183). At present that is the frequency of its meetings.

#### 4. Proposal in the Consultation Paper

The SEM Committee proposed in the Consultation Paper (SEM/09-065) that the Code should recognise that there are further Modification Proposals that should be subject to the fast-tracked “Urgent” Modification process under the Code. The SEM Committee does not believe that such a facility should be widely available and takes the view that it should be used with discretion. However, where the RAs are seeking to implement a regulatory change that impacts upon the Code and in relation to which they have already undertaken public consultation and have published their conclusions based upon that consultation, the SEM Committee takes the view that a more timely process for bringing a Modification Proposal through the Modifications process is called for.

The SEM Committee therefore proposed that any Modification Proposal which meets the following criteria, may be designated as a ‘RA Modification Proposal’ and treated in the same way as a Modification Proposal which is deemed to be “Urgent” under the Code:

- the Modification Proposal is submitted by the RAs and is classified by the RAs as a RA Modification Proposal; and,
- the RAs have already undertaken public consultation, and published their conclusions or decision on the subject that the proposed changed legal drafting in the Code addresses.

These criteria are suggested to allow for RA Modification Proposals to be progressed in a more efficient manner and without requiring the Modifications Committee to duplicate the consultation process(es) which has already been undertaken by the RAs outside of the Code. Importantly however, the process suggested in the consultation paper aims to ensure that both the Code Modifications process is not sidelined and that the Modifications Committee can take a view on the implementation in the Code of the regulatory action of the RAs so that the skills and experience of the Committee can be used to enhance RA Modification Proposals.

The consultation proposed the following amendments to the Code should the consultation proposal be accepted:

The Code should be amended to introduce a new classification of Modification Proposal (proposed to be known as an ‘RA Modification Proposal’), which meets the criteria set out above and which shall be treated the same as a Modification Proposal designated as “Urgent” under paragraph 2.208 of the Code. It is proposed to do this by making the changes to the Code shown below:

#### **Urgent Modifications and RA Modification Proposals**

2.206 Any person submitting a Modification Proposal may mark it as “Urgent”. A person submitting a Modification Proposal marked “Urgent” shall submit the Modification Proposal to the Secretariat and to the Regulatory Authorities.

2.207 The Secretariat shall, as soon as possible on receipt of a Modification Proposal which is marked "Urgent", contact the Regulatory Authorities which shall determine whether or not it shall be treated as Urgent.

2.208 A Modification Proposal shall be determined to be Urgent by the Regulatory Authorities where, if not made, it can reasonably be anticipated that the event or circumstance with which the Modification Proposal is concerned would imminently:

1. threaten or prejudice safety, security or reliability of supply of electricity; or
2. unduly interfere with, disrupt or threaten the operation of the Single Electricity Market; or if a Modification is required to correct an obviously material error or inconsistency in the Code.

2.209 If the Regulatory Authorities determine that a Modification Proposal is Urgent under paragraph 2.208 or if the Modification Proposal is a RA Modification Proposal, the Modifications Committee shall convene an Emergency Meeting.

2.210 If the Secretariat or the Modifications Committee considers that any of the criteria in paragraph 2.208 apply in respect of any Modification Proposal that has not been marked "Urgent" by the person submitting the Modification Proposal, the Secretariat shall promptly submit the Modification Proposal to the Regulatory Authorities for consideration in accordance with paragraph 2.207 and 2.208.

2.211 In the event that a Modification Proposal is deemed to be Urgent or if the Modification Proposal is a RA Modification Proposal, the Modifications Committee shall propose the procedure and timetable to be followed in making a recommendation in respect of the Urgent Modification or RA Modification Proposal which may fast-track the normal processes provided for in this Code. The Regulatory Authorities shall have the right to veto or direct amendments to the procedure and timetable proposed by the Modifications Committee within 2 Working Days of any such proposal by the Modifications Committee.

## Glossary

**A RA Modification Proposal** means a Modification Proposal submitted by a Regulatory Authority which is classified by the Regulatory Authorities as a RA Modification Proposal and where the Regulatory Authorities have already undertaken public consultation and published their conclusions or decision on the subject that the proposed changed legal drafting in the Code addressed.

The SEM Committee sought comments on this proposal.

## 5. Responses to the Consultation

The RAs received ten responses to the consultation (SEM/09-065) which have been published along with this decision paper. Responses were received from the following parties:

1. Airtricity;
2. Bord Gáis Energy;
3. Endesa Ireland;
4. ESB Networks;
5. ESB Power Generation;
6. NIE Energy (Supply);
7. NIE Energy (Power Procurement Business);
8. Single Electricity Market Operator (SEMO);
9. Synergen; and,
10. Viridian Power and Energy.

Some respondents were in favour of the proposals; however the majority expressed some concerns about the proposals. One respondent sought clarification on the proposal and had no objection to the change.

The responses received can be summarised under the following headings. We have given a SEM Committee response where necessary.

### *1. Process Already in place for the RAs to modify Code*

A number of respondents commented on the fact that there is already a mechanism in place by which changes can be made to the Code and the RAs can use this process. These respondents consider the current framework to be adequate.

Some respondents considered there to be no undue delay on the part of the Modifications Committee. One of these respondents noted that while the Modifications Committee may take up to eight months to consider a Modification, in practice the average time taken is far less than this with over three-quarters of Modifications raised to date being concluded at the Committee level within 3 months. Another of these respondents said that the maximum timeline is unlikely to apply in the context of a Modification that has already been widely consulted upon as the Modifications Committee is unlikely to duplicate processes already undertaken outside the Code.

The SEM Committee accepts that there is currently a process in place for the RAs to modify the Code; however it considers that a more time-efficient process (where a timetable for the Modification is drawn up) is appropriate which would assist the RAs in implementing policy decisions that have previously been consulted upon, without delay. The SEM Committee accepts that for the majority of

Modifications, the Modifications Committee make a decision on them within a reasonable period of time.

## 2. *Urgency Determination*

One respondent commented on the fact that if the normal process doesn't work and the matter is sufficiently urgent, then it could be expected that the RAs could determine the modification to be urgent and therefore could be fast-tracked according to the usual process. The SEM Committee does not agree with this view as it is believed that most Modifications that will be raised as a result of RA policy decisions will not fall into the current classification of an Urgent Modification.

One respondent noted that the current Urgent Modifications process was designed specifically to deal with Modifications that address three distinct circumstances or events and there would need to be clear and compelling rationale for changing or expanding the scope of the Urgent Modifications process which balances any benefits in terms of speed against both criteria or robustness of process and a clear delineation of regulatory and participant roles in the Modifications process, notably with respect to regulatory risk. This respondent does not believe that compelling rationale is presented for why RA Modifications should follow the Urgent Modifications procedure and to change the modifications process in the manner set out in the consultation paper. The SEM Committee considers that the merits of expanding the Urgent Modification criteria were presented in the consultation paper and that these were sufficient to warrant expanding the criteria.

One respondent noted that in considering whether the class of urgent proposals should be expanded to include certain proposals introduced by the RAs, this respondent agrees with the view of the SEM Committee that the special fast-tracking procedure should be used with discretion and that both criteria of being classified as an RA Modifications and a previously undertaken public consultation on which the conclusions or decisions are published are important.

## 3. *Modifications Committee's Role*

Three respondents noted that the Modifications Committee have the ability to consult so by the RA's carrying out a consultation in advance of raising a Modification Proposal and "*engaging in an ex-ante consultation and change process outside the role*", this undermines the integrity of the Modifications Process and the role of the Modifications Committee. These respondents also suggested that it is not clear why a modification proposal could not be submitted in parallel under the current terms of the Code (or at an early stage) and therefore be in the pipeline for consideration as this may provide an opportunity for the RAs to draw on the industry expertise within the Modifications Committee to assist in ensuring the proposals are well structured and that any consultation is appropriately focused.

The SEM Committee does not accept this comment as it is their view that a Modification Proposal cannot be raised until the policy has been decided upon, at which stage the initial legal drafting is drawn up. If a Modification Proposal was raised before a final decision on the matter, this may be seen as pre-empting the policy decision by the RAs. Any proposal which the SEM Committee decides to



submit will be subjected to full and thorough consideration by the Modifications Committee in line with the current processes.

One of these respondents further noted that the Modifications Committee was created with the objective to progress the Modification Proposals with a view to better facilitating the achievement by the Code of the Code Objectives, one of which is to provide transparency in the operation of the SEM and by creating a preliminary process (consultation), the SEM Committee has introduced the risk of the RAs being seen as willing to bypass the Code when suits.

The SEM Committee rejects this reaction since it has not proposed to bypass any element of the Modifications Process; in fact the Code does not permit any such bypassing. The SEM Committee is aware that it could have submitted a proposal directly to the Modifications Committee without any prior consultation on the topic, but took the view that a Modification Proposal that concerns important regulatory policy was of sufficient regulatory significance to warrant wider consideration before any such Modification Proposal is raised. As much as it is the Modifications Committee's role to develop Modification Proposals, it is the RAs duty to consult on policy matters and therefore raising a Modification before a final decision is made is not possible.

One respondent believed that the new process would be a useful addition and that it is a reasonable approach to streamlining certain code alternations and will avoid unnecessary duplication of effort especially with regard to public consultations.

Two respondent noted that the Modifications Committee performs an important role (which is not generally addressed in the RA public consultations which discuss principles of policy) in assessing the known and potential impacts of proposed Modifications on the Central Market Systems, market participants, the consequential impacts of Code changes on other parts of the Code and on the functioning of the SEM as a whole. They believe that the finer details of this cannot be assessed until the specific legal drafting of the Modification proposals are presented and that the Modifications Committee is best placed to assess market changes, identify consequences of policy, identify the impact on market participants IT systems and business processes and suggest optimal implementation of changes to the Code and Central Market Systems. In this regard, one respondent welcomes the fact that the consultation paper refers to the need for proper review by the Modifications Committee of Code amendments.

The SEM Committee accepts this distinction and agrees that it reflects the difference in the roles of the RAs and the Modifications Committee. The SEM Committee does not seek to amend or to weaken the role of the Modifications Committee and values its contribution to the development of Modification Proposals as indicated by the approval of more than 95% of all Modifications submitted to the RAs. The SEM Committee recognises that any Modification Proposal submitted to the Modifications Committee by the RAs should be subject to the same level of analysis and review as any other proposal. However, it is also the SEM Committee's view that as such a Modification Proposal would

have been previously widely consulted upon and is therefore not raised unexpectedly, a more timely process may be warranted.

A respondent proposed that where the RAs seek Modifications that they believe are necessary to implement changes to the Code that are RA policy led, these Modifications could instead be taken forward under a separate procedure where there is a closer liaison between the RAs and the Modifications Committee on the implementation of potential rule changes. The SEM Committee believe the Modifications Committee (and working groups, if needed) is this forum. The Modifications Committee do not have a direct role in the consideration of regulatory issues, though the members of the Committee have an interest and their input into regulatory consultations is always welcome. Under paragraph 2.149 of the Code, the Modifications Committee has the role of developing Modifications Proposals from initial idea through to a final, well worded and thought out proposal with an implementation timetable and cost. However, the SEM Committee cannot see how it would be appropriate to commence this latter detailed consideration of a possible change to the Code until a regulatory decision has been reached on the wider issue being consulted upon. Any consideration of possible future Modification Proposal would not only pre-suppose a regulatory decision but also operate outside the Modifications Process in the Code.

One respondent said that the RA's proposals in the consultation paper maintain the integrity of the modifications process and facilitates further industry input through the Modifications Committee.

One respondent considers that the approach suggested if adopted would:

- Be perceived as an attempt to micro-manage the Code development by allowing for increased RA determination of Modifications, essentially an expansion of the existing “proposer and judge” provisions; and,
- Stand outside the Code process as it presently exists (where the RAs already have an enhanced role in proposing Modifications compared with regulatory bodies in many other wholesale electricity market governance arrangements).

The respondent believes that these factors would serve to increase regulatory risk, both to existing participants and potential new entrants.

One respondent noted that this proposal substantially increases the perception of regulatory risk which could be damaging to both investors and consumers, particularly in the current financial climate. This respondent said that with future regulatory developments likely to result in increased amendments to the Code, it is more important than ever to maintain the current modification process.

In relation to the last two respondent's comments, the SEM Committee does not accept that its proposal increases regulatory risk. It is not proposing changes to the Modifications Process except to enable RA policy Modifications to be considered in a more time-efficient manner by both avoiding the need to await the next scheduled Modifications Committee meeting and requiring the Modification to

be subject to an agreed process and timetable leading to the submission of the Modifications Committee report to the RAs. Neither of these elements affects the role of the Modifications Committee in reviewing, developing and assessing Modification Proposals; it merely adds an emphasis on timeliness for Code changes which result from regulatory issues.

#### 4. *Legal Drafting Issues*

Several respondents commented on the legal drafting of the Modification proposal and some useful suggestions were noted. The suggestions/comments were as follows:

- Add a further criterion in paragraph 2.208 which would be a simpler approach to implementing the proposed change in the Code and may avoid specific reference to RA Modifications as this may heighten concerns about regulatory risk in the market;
- Amend the definition of an RA Modification proposal as it is circular;
- Amend the drafting to ensure consistency within the Code by modifying the definition of RA and adding new paragraphs 2.206a and 2.208a. This respondent also suggested that any RA Modification Proposals should be agreed in advance by the SEM Committee and this should be reflected in the Code; and,
- One respondent sought to clarify whether the RAs intend to amend section 3.6 Agreed Procedure 12 (Modification Committee Operation) as there were no suggested changes in the consultation paper.

The SEM Committee is conscious that an important part of the Modifications Committee role in the development of any Modification Proposal is to review the proposed legal drafting and seek ways of making improvements to the drafting for submission in their report to the RAs. The proposed legal drafting in the RA Modification Proposal will therefore be given further consideration by the Modifications Committee as part of their assessment of the proposal.

#### 5. *System Changes Impact*

One respondent, who *“recognises that there may be instances where RA proposals, having undertaken public consultation, may need to be fast-tracked under the Urgent Modification process under the Code”*, wished for clarification on how the process would be handled if there were system changes involved and would the effective date of the proposal take this into consideration (as system changes may take some time to implement).

The SEM Committee notes that the process for the determination of the detailed timing and content of software releases in relation to the Market Systems is still being fully developed by SEMO, however SEMO have put in place an effective interim process for the April 2010 release. In the future, it is expected that there will be two such releases each year and that the overall process for defining the

content, developing and testing the software and implementing the revised systems will take about 9 months.

One respondent accepts that changes to the Code as a result of decisions taken by the SEM Committee should be fast-tracked to ensure these can be implemented swiftly. This respondent believes that prior to making such a decision or submitting a modification, the RAs should seek input from the Modifications Committee to determine the most cost-effective, least complex means of implementing the Decision and to ensure that it does not cause unexpected distortions.

One respondent said that proper review of Modifications by the Committee which have Central Market System change dependencies involves a vital impact assessment stage. The processing of these impact assessments by SEMO and the CMS vendor is dependent on their resource allocation and schedule of work. SEMO would be concerned that a request to fast-track a given impact assessment may result in the disruption of work on scheduled releases. This in turn may lead to more costly changes to the Market. Similarly, fast-tracking Modification Proposals may have a significant impact on current or planned release scope deliverables.

In response to the last two comments, the SEM Committee will endeavour to engage with the Modifications Committee and SEMO as early as possible in the process so there is sufficient time for an impact assessment to be carried out. As SEMO have pointed out an impact assessment of the Modification Proposal is necessary (and therefore unavoidable) however the SEM Committee will try to minimise any negative impact it may have on other Modification Proposals.

One respondent suggested that any consultations by the RAs on Modifications that are subsequently submitted by the RAs should include both a full impact assessment and proposed Code changes. The SEM Committee cannot propose Code changes (and therefore an impact assessment cannot be carried out) until a policy decision has been finalised. Once a Modification Proposal is raised, it is the Modifications Committee's role to suggest changes to the legal drafting text proposed. Similarly, an impact assessment cannot be carried out until the code changes are known.

## **6. Decision**

Taking the above considerations into account in addition to the comments received, the SEM Committee has decided that it will submit a Code Modification Proposal to the Modifications Committee which seeks to allow a 6-month timeline<sup>4</sup> for Modification Proposals categorised as “RA Modification Proposals”. A 6-month timeline is considered reasonable in this regard as sufficient time for Modifications Committee deliberations is allowed for, yet a shorter time period for a recommendation from the Committee is also facilitated. Changes driven by regulatory processes, which have been consulted upon previously, should be the subject of a shorter review period by the Modifications Committee, leading to a timely report to the RAs.

In addition, the SEM Committee recommends that for Modification Proposals which may be more complex (such as those categorised as “RA Modification Proposals”), the Modifications Committee Secretariat should prepare a detailed timeplan to facilitate efficient submission of a final recommendation report to the RAs, upon such a Modification Proposal being discussed at the Modifications Committee.

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<sup>4</sup> As currently provided for under paragraph 2.192 of the Code, the Modifications Committee can request an extension to this timeline.