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RE: I-SEM Roles and Responsibilities, Consultation Paper, SEM-15-016 (“the Consultation”)

Dear Elaine and Leigh,

Bord Gáis Energy (“**BGE**”) welcomes this opportunity to respond to this consultation on the assignment of roles and responsibilities to entities for certain tasks in I-SEM. In light of the operational impact and commercial implications of the execution of these tasks, it is crucial that they are executed in a transparent and efficient manner.

1. Introduction

BGE is a strong advocate of the need to utilise synergies insofar as possible in order to minimise administrative burdens and incidentally costs of operation, which costs will ultimately be borne by the consumer. Concerns over potential conflicts of interest must however also be eliminated on the assignment of the various tasks outlined in the Consultation. Striking a balance between these two objectives heavily influences BGE’s views on the appointment of appropriate entities. The potential conflicts, in the current market context, in BGE’s view stem from:

- i. the Market Operator (“**MO**”) and TSOs being owned and controlled by the same company, EirGrid Plc and the lack of legal or functional separation between the MO and TSOs; and
- ii. the on-island TSOs and (soon-to-be) TSO of the East West Interconnector (“**EWIC**”), being owned and controlled by EirGrid Plc.

This response outlines areas where potential conflicts of interest arise and discusses the benefits of drawing on synergies before going on to provide a view on the appropriate entities to carry out the respective tasks identified in the Consultation. The response concludes by supporting the SEM Committee (“**SEMC**”) proposal for the NEMO assignment process, but suggesting additions to the NEMO tender criteria mainly to account for BGE’s view on the need for expansion of the NEMO role in I-SEM.

2. Conflicts of Interest

As market participants have differing, and sometimes conflicting, objectives it is important that there is a clear delineation of roles and transparency in the price formation and settlement processes in I-SEM. The focus should therefore be on ensuring full, effective separation of roles and independence in the carrying out of relevant functions to provide all parties with confidence in market outcomes.

BGE believes that confidence in such market outcomes could be undermined by potential conflicts of interest with regard to system and market tasks, unless certain separation measures are adopted. Potential conflicts together with proposed measures to eliminate such conflicts are outlined below.

2.1 Market Operator (“MO”) / System Operator (“SO”) Conflicts

The MO provides a vital role in providing confidence in market outcomes, particularly pricing and settlement. Given the expanding number of market timeframes and hence outcomes under I-SEM it is necessary to ensure the MO is operationally and functionally separate to the SO given their divergent objectives. This will become increasingly important as the SO becomes an active counterparty in certain of the markets, namely the balancing and ancillary service markets.

An independent MO will be necessary for all market participants to have confidence in market outcomes and settlements. If the chosen MO remains in the ownership of EirGrid Plc, suitably robust ring-fencing arrangements should be adopted and consulted upon with market participants. The tender for the NEMO should require applicants to submit a detailed and robust explanation of the independence and separation of the MO from any other entity in the market to assure confidence in market outcomes.

2.2 On-island SO/ Interconnector SO Conflicts

Notwithstanding the pending registration of the East West Interconnector Limited (“**EWIL**”) as a TSO, BGE believes that significant potential conflicts of interest exist by virtue of EirGrid’s control of on-island system operation (EirGrid and SONI) and ownership and control of the East West Interconnector asset. These conflicts would be best eliminated by substantial ring-fencing of EWIL from the EirGrid group particularly from a financial perspective. The primary conflicts arise in the context of TSO decisions being influenced by the impacts of operational decisions on EWIL revenues and in EWIL’s participation in the ancillary service market, where it will compete with independent units for contracts with the on-island TSO(s).

When the TSOs and EWIL are both owned and controlled by EirGrid, sharing the same treasury and strategic decision making functions, any TSO actions that may have to be taken that include operational changes on the interconnector are likely to be influenced by any implications in terms of financial exposure for EWIL, if FTRs are curtailed.¹ The potential for this conflict to arise recently manifested itself in the attempt by the Irish TSOs to cap compensation for FTR curtailment in times of any “capacity shortage” on the SEM-GB interconnectors.² Capping of FTR curtailment compensation would also further undermine forwards liquidity to the ultimate detriment of the consumer. The scope for the TSOs to use its position to minimise EWIL’s commercial risk cannot be maintained in the interests of fairness and competition for the market.

BGE is also concerned that EirGrid will have a conflict of interest in the DS3 auctions, particularly if it is charged with administering the auction and choosing providers of ancillary services. EWIL competing directly with market participants could hinder both auction outcomes and legitimate competition.³ EWIL’s participation in DS3 auctions also raises concerns around compliance with the Third Energy Package⁴ as arguably, EWIL’s offering of reserves is akin to electricity production.

In BGE’s view, the preferred solution to these potential conflicts of interest is to make the TSO and EWIL legally and functionally separate with strict ring-fencing arrangements particularly with regard to its finance structure. The Gaslink/ Gas Networks Ireland separation approach is considered useful precedent in this regard.⁵

3. Synergies

Notwithstanding the identified conflicts of interest that could exist in I-SEM, BGE is a strong proponent of using synergies in the interests of the consumer from a cost and administrative-burden perspective.

Establishment of a truly independent NEMO, as discussed in Section 2 above, that is assigned a number of similar roles in the I-SEM can garner efficiency from the administration, operation and settlement of many markets. BGE believes that the role of NEMO should and can be expanded to maximise synergies in I-SEM.⁶

¹ Curtailment of Financial Transmission Rights (FTRs) implies the need to pay interconnector rights’ holders

² Annex 12 of ENTSO-E consultation on Draft Allocation Rules for Forward Capacity Allocation, 2 March 2015 version

³ E.g. due to information sharing capabilities, EWIL may be better-placed to submit bids ensuring their success in the auction

⁴ Article 9(1)(b)(ii) of the Electricity and Gas Directives prohibits the same person(s) from directly or indirectly exercising control over a TSO or over a transmission system, and directly or indirectly exercising control or exercising any right over an undertaking performing any of the functions of production or supply

⁵ The 2005 legislation pursuant to which Gaslink was established is the European Communities (Internal Market in Natural Gas) (BGÉ) Regulations 2005, S.I. 760, 2005

⁶ For example, registration with one single entity would minimise transaction costs (e.g. resulting in credit cover and collateral requirement cost-efficiencies); the utilisation of systems and sharing of expertise for the various market settlement roles will also lead to cost-savings

The assignment of tasks pursuant to this Consultation should be guided by the simplicity of choice taking into account current capabilities and experience of parties as well as the need to avoid conflicts of interest.

4. Designation of Roles and Responsibilities

BGE’s views on the designation of roles and responsibilities are heavily influenced by the above discussion as well as the view that these assignments should be kept simple and cost effective. There is an overarching need for transparency in operation of the SOs and MO as well as appropriate separation/ monitoring/ application of rules for both entities.

| Role/ Responsibility | BGE Preferred Body | BGE Reasoning for Preference |
|---|--------------------|---|
| Day Ahead Market Operation & Settlement | NEMO | In line with CACM Network Code |
| Intraday Market Operation & Settlement | NEMO | In line with CACM Network Code |
| MCO | NEMO | Consistent with current MO role. Assign to third party only if cost-effective |
| CCP | NEMO | Agree with SEMC |
| Balancing Market Operator Role | TSO/ NEMO | Agree with SEMC proposal and draft Balancing Network Code specification that real-time system balancing is a core TSO function. However, in GB Elexon also has a role in Balancing Energy Settlement (as well as imbalance settlement) settling Bid-Offer Acceptances between the TSO and relevant balancing & settlement code parties. NEMO should have a similar balancing market role. |
| Settlement of Imbalances Role | NEMO | <p>While balancing market operation is a core TSO function, imbalance settlement should be an entirely discrete process. If the settlement body was the TSO or SEMO in its current structure, determination of imbalance prices would undoubtedly be influenced by the TSOs’ objective to minimise Dispatch Balancing Costs (“DBC’s”). This would impinge on market participants’ confidence in balancing and imbalance prices which could translate into higher costs for consumer.</p> <p>TSOs should assign the task of imbalance settlement to a third party (the MO) as provided for under the draft Balancing Network Code (“NC”). This would provide transparency and confidence in market outcomes whereby a suitably independent NEMO is indifferent to those outcomes. Provided the TSO relays the required meter data, the MO should be capable of carrying out the additional tasks noted in the Consultation. Further, administration of market rules and managing collateral arrangements/ registration/ invoicing/ currency risk/ resettlement is not within the current capabilities of the TSOs and should stay with a MO. Elexon’s role in GB is considered a possible model for I-SEM given its role not only in balancing Bid-Offer acceptances but also in imbalance settlement separate from the TSO. Elexon is wholly-owned but not controlled by the TSO and is not consolidated in the TSO’s financial statements. Furthermore, if pursuant to the Balancing NC, a TSO request for delegation to an MO is not forthcoming, the legislative changes needed to ensure this can occur should be initiated as early as possible.</p> <p>Separating the functions of balancing market operation and balancing/ imbalance settlement should be reinforced by prescribing strict and highly transparent rules for TSO balancing actions (e.g. flagging and tagging). The rules should: be set by the Regulatory Authorities (“RAs”); be applied by the independent MO; be independently monitored by the RAs who should reserve a right to apply corrective actions if unsatisfactory outcomes still arise.</p> |
| DS3 Auctions | NEMO | Based on BGE’s views that an independent MO would be indifferent to the commercial outcomes in the market (particularly any outcomes that may impinge on SO revenue recoverability), BGE submits that an independent MO should also run the DS3 auctions. ⁷ |
| Capacity Mechanism | NEMO | The TSOs’ obligations to operate a safe and secure power system do not justify it being the Capacity Mechanism (“CM”) Delivery entity nor does it trump the |

⁷ NEMO could carry out the administration based on rules established by the RAs. EirGrid Interconnector Limited would participate in auctions on a level playing field with/ in the same way as, all other DS3 market participants

| | | |
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| Delivery Role | | <p>opportunity to use synergies. As an independent MO is indifferent to market outcomes, and as the MO should run DS3 auctions, the benefits of synergies would imply that the MO should also run CM auctions. The majority of the new requirements of the CM are commercial or administrative in nature (e.g. pre-qualification, auctions, contractual counterparty, collateral requirements) and the TSOs should not stray into the commercial workings of the CM.</p> <p>Agreeing with the SEMC's view that current TSO competencies that will remain applicable for the new CM should remain with the TSO,⁸ their role in the CM should be limited to their technical expertise and inputs and the transfer of relevant data to the Delivery and Settlement entity - NEMO. The regulators should have close oversight of the processes and rules involved in this role.</p> |
| Capacity Mechanism Settlement Role | NEMO | <p>As the delivery body for the CM, the NEMO would be best placed to carry out settlement requirements and administration of collateral and secondary trading arrangements. Furthermore, BGE agrees with the SEMC that cost and administration synergies apply to having capacity settlement carried out by the same entity responsible for imbalance settlement, thus the MO should settle balancing, imbalance and capacity payments. Benefits of a single entity settling across all markets, e.g. a netting of payments, are supported.</p> |
| Forward Contracting Roles | Status quo until Single Allocation Platform | <p>In light of the CACM NC stipulation that NEMOs collect congestion income from the day-ahead timeframe to distribute to the TSOs for reimbursement of financial transmission rights ("FTRs") holders, until the Single Allocation Platform is in place to allocate and settle FTRs, it appears that subject to discussions in the Forwards and Liquidity workstream the current process of SONI allocating rights and interconnector owners reimbursing FTR holders when required, would make the best use of current capabilities. In the interests of forwards liquidity the RAs are considered best placed to monitor FTR implementation pursuant to strict rules.</p> |

Table 1: BGE's opinion on the appropriate entity to which I-SEM roles and responsibilities should be assigned

5. Process of NEMO designation

BGE agrees with the SEMC and the relevant departments' decision that no legal NEMO monopoly should be invoked and that the NEMO role should be tendered for. Designation of a NEMO to apply to the island as a whole is considered to be in the best interests of consumers.

BGE welcomes the CACM stipulation that the NEMO's initial designation period is 4 years but would welcome clarity on the anticipated usefulness of accepting NEMO applications annually. It would not be considered conducive from a cost or certainty perspective, for market participants to have to consider changing systems/ interfaces regularly in line with changing MOs.

BGE suggests the addition of further designation criteria mainly in light of our view that the role for NEMO should expand beyond day-ahead and intraday markets in order to eliminate potential conflicts of interest and fully utilise synergies. The proposed additions include:

- Criterion 6.1. (a): The evidence of capability to deploy resources for NEMO functions as well as evidence of proposed operation of markets should extend beyond day-ahead and intraday functions and operation into all of the other areas identified as potential NEMO roles in Table 1; ability to provide resources should be proven at a specified date rather than "sufficiently in advance" of Q4 2017 given the importance that abilities can be applied in due time;
- Criterion 6.1. (b): The ability to publish relevant information should be proven for all markets the applicant has ability to operate not just day ahead and intraday; such information should be publishable in a timely manner;
- Criterion 6.1. (c): The most cost-effective solutions should be demonstrated for all market roles, not just day ahead and intraday; if MCO functions are not cost effective to outsource to a third party, separate internal accounts for MCO functions from other activities should be required to prevent cross subsidisation; applicants should be required to demonstrate their ability to report a clear break down of all NEMO costs;
- Criterion 6.1. (d): A right to impose stricter business separation at a later date if the separation is not working effectively, should be reserved to the RAs;

⁸ E.g. includes setting capacity requirement; calculating availability for settlement purposes; testing providers' ability

- Criterion 6.1. (e): Separate accounts to prevent cross subsidisation should apply for all market roles the MO is capable of carrying out, not just day ahead and intraday;
- Criterion 6.1. (f): A description of internal processes for making sure operational arrangements, contractual arrangements, and services to market participants are not discriminatory should be required; information and consultation on market developments should extend to all markets the MO could manage;
- Criterion 6.1. (h): The evidence should not just be “related to market information”- that phrase should be omitted; the applicant should include a description and explanation of processes to assess what transparency and confidentiality agreements are required and how these will be agreed with Market Participants and TSOs;
- Criterion 6.1 (i): The evidence being sought to be provided by the tendering company should extend to all markets which BGE believes the NEMO should be involved in as per Table 1;
- Criterion 6.1 (j): A breakdown of costs of providing such systems and agreements for all markets the NEMO could manage should be sought.

6. Conclusion

In conclusion, BGE believes that there are potential conflicts of interest pursuant to the ownership and control by EirGrid Plc of the MO, on island system operation and EWIL. Delineation of roles and transparency in market processes is necessary to provide confidence to market participants in I-SEM outcomes. In order to eliminate these potential conflicts and best use synergies, BGE submits that the MO and TSOs should be operationally and functionally separate such that the MO is indifferent to market outcomes. A truly independent MO will be in a position to undertake a number of functions in I-SEM (outlined in Table 1) that gives confidence to participants in market outcomes and administration and would be able to benefit from economies of scope and scale that lead to cost savings. The role of Elexon in GB is considered useful precedent for balancing and imbalance roles in particular.

BGE also believes that separation of EWIL into a legally and functionally separate entity should be considered given the potential for conflicts to arise between SO operational objectives and EWIL objectives to maximise interconnector revenues. The Gaslink/ Gas Networks Ireland separation is considered a useful precedent in this regard.

I hope that you find the above opinions and suggestions helpful and should you have any queries, please do not hesitate to contact me.

Yours sincerely,

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{By email}