



**Energia response to I-SEM Roles and
Responsibilities**

Consultation Paper SEM-15-016

17 April 2015

1. Introduction

Energia welcomes this opportunity to respond to the SEM Committee Consultation Paper (SEM-15-016) on I-SEM Roles and Responsibilities.

This response is structured as follows. Section 2 covers synergies, conflicts of interest and governance. Section 3 considers the assignment of roles and responsibilities proposed. Section 4 comments briefly on the process of NEMO designation. And finally section 5 provides our responses to the questions consulted upon.

We would welcome further dialogue with the regulatory authorities (RAs) on these issues, particularly on how to ensure the interests of all-island consumers and market participants can be appropriately represented at EU level and how to maximise synergies whilst addressing potential conflicts of interest in I-SEM.

2. Synergies, conflicts of interest, and governance

It is stated in the consultation paper that the SEM Committee's focus is "...on reducing costs to consumers by achieving synergies where possible and mitigating conflicts of interest where they lead to increased consumer costs".

Given the small size of the all-island market we strongly agree with the RA's focus on achieving synergies where possible. By having one entity discharge all I-SEM market operator roles, we believe that synergies can and should be achieved, including: cost savings associated with economies of scope; cost savings associated with economies of scale; and importantly a reduction in transaction costs associated with interfacing with the market and meeting credit / collateral requirements.

We agree that conflicts of interest should also be an important consideration but the effects are more nuanced and far reaching (increasing consumer costs in the longer term) than implied in the consultation paper given its rather limited focus on conflicts that "could translate into higher costs for all-island consumers" which is further qualified by the 'ability' and 'incentive' of the party to act on such a conflict¹. It is important to clarify that the perception of potential conflict (whether exercised or not) is sufficient to distort competition and deter investment and should therefore be dealt with robustly. Furthermore, if there is a potential conflict of interest there is inherent ability and incentive to act upon it by definition. We understand that the analytical framework proposed in the consultation paper to assess conflicts of interest and manage them under I-SEM is taken from the DECC and Ofgem approach regarding National Grid's role in Electricity Market Reform (EMR) in GB but

¹ See steps required to address conflicts of interest on page 22 of consultation paper.

we do not consider this appropriate, both for reasons stated above and because National Grid's role in EMR is a very different context.

The consultation paper considers the potential for conflicts of interest arising from the same entity performing the market operator and TSO roles in the I-SEM and provides examples on pages 22 and 23 to illustrate where such conflicts could arise. The examples provided are plausible and are by no means exhaustive. Potential conflict could materialise in a variety of ways which may not always be obvious or even deliberate and therefore it would be prudent to avoid the possibility of conflict where possible and where the potential still exists seek to put in place appropriate mitigation measures.

The potential for conflict is even greater with EirGrid as asset owner of the East West Interconnector (EWIC) but disappointingly this has been de-scoped from the consultation paper to be considered later as part of the TSO certification process, and without clarity on whether the issue will be consulted upon at that stage. We would strongly encourage further consultation on the treatment of EWIC and would stress that the proposed solution in relation to the potential DS3 conflict has significant shortcomings because it will have the effect of further concentrating an already highly concentrated market for DS3 services and it could be difficult to independently verify if EWIC volumes are over-stated. The potential for conflict in relation to EWIC is also broader than DS3. For example the potential for conflict also needs to be considered in the context of the capacity mechanism and TSO imbalance incentives. It should further be noted that whilst TSO ownership of interconnectors is common elsewhere in Europe, there appears to be greater potential for conflict in the all-island market given common TSO/MO ownership, the type of interconnection (DC versus AC), and the nature of the market with a relatively high demand for system services to facilitate wind. Thus potential conflicts arising from EirGrid's ownership of EWIC should be eliminated or robustly managed.

The consultation paper states on pages 4-5 "that it is important that the key entities responsible for the development of the CACM processes for I-SEM are designated as soon as possible in order to avoid delayed implementation and to ensure that the interests of all island consumers and market participants are represented at EU level in developing the rules, methodologies, terms and conditions of the day ahead and intraday market coupling".

Presumably adequate representation at EU level is also affected by PCR membership and we would welcome further clarity around this. It is also essential that there is an informed debate on the governance arrangements for the DAM and IDM. Given the I-SEM relies solely on EUPHEMIA and XBID to schedule the day-ahead and intra-day markets (they are the only means by which participants can secure a contract position prior to dispatch by the TSO

via the balancing market) it is essential that participants understand the governance arrangements that are in place at EU level or that will be put in place for these markets and the potential risks they present for participants and consumers under the I-SEM design. There are also important questions of internal governance to be considered that are not addressed in the consultation paper. For example how are views of the all-island market determined? This would need some form of industry representative committee, perhaps akin to the current Modifications Committee. How can it be ensured that these views are represented at EU level? What obligations can be placed on the NEMO to represent the views and interests of the all-island market? What happens if the NEMO is conflicted by representing another jurisdiction or has commercial interests contrary to the views of the all-island market?

3. Assignment of roles and responsibilities

We agree that the Balancing Market Operator is a core TSO role. We also acknowledge, as stated in the consultation paper, that this role is closely related in its purpose to the scheduling and dispatch mechanism that is currently undertaken by the TSOs in the SEM. However, the context is different in I-SEM and this should be reflected in the TSO's approach to managing the system. For example the TSO approach to dispatch under I-SEM should be determined with reference to the I-SEM design and philosophy rather than maintaining the current TSO procedures and systems under the new market arrangements without sufficient consideration of the potential impacts of this on the overall functioning of the market or the commercial risks it places on participants. The objective function of the Balancing Market should also reflect the I-SEM design and philosophy, recognising that minimising the cost of dispatch is not necessarily equivalent to minimising the cost of deviating from physical nominations. These are important issue to consider and address, both in designing the energy trading arrangements for I-SEM and defining the role and objective of Balancing Market Operator through licence and / or legislative changes in both jurisdictions as applicable.

We agree (without agreeing with all stated reasons in the consultation paper) that the Capacity Mechanism Delivery role should be a TSO function, but only providing that potential conflicts arising from EirGrid's ownership of EWIC are eliminated or robustly managed (as discussed above), and irrespective of this, that the delivery body role does not extend to the design of the capacity mechanism (or its subsequent modification). The consultation paper states that TSOs should be the delivery body for the I-SEM Capacity Mechanism because they are responsible for a safe and secure power system which aligns with the aims of the capacity mechanism to ensure security of supply in Ireland and Northern Ireland. We do not consider this stated rationale

relevant or appropriate to the question of who should be delivery body for two reasons. First, as already mentioned, the design of the capacity mechanism does not appear (and should not be) within the scope of the delivery body role. And second, long term security of supply is not the primary responsibility of the system operator from a generation adequacy perspective. Primary responsibility rests with the regulatory authorities, acting on behalf of consumers. Discussion of the system operator's obligations to ensure a safe and secure power system should not therefore be confused with obligations to maintain long term generation adequacy which is the function of a capacity mechanism.

We agree with the minded-to position that the Capacity Settlement Role could be carried out by the entity responsible for the Settlement of Imbalances. We would further suggest (subject to comments in section 2 above on governance and conflicts of interest) that the small size of the all-island market and the unique features of the I-SEM arrangements provide a strong basis for having a single market operator cover all the administration and settlement functions across the Day Ahead, Intra-Day, Balancing, Forward, Ancillary Services and Capacity Markets. We see merit in having a single NEMO for I-SEM that also performs all other market operator and settlement functions listed above, subject also to our comments in section 2. We believe this approach should be used to maximise potential synergies in terms of credit / collateral and the market interface with participants.

4. NEMO designation

Under the topic of NEMO designation the consultation paper is inviting comments on the RAs' interpretation of the NEMO designation criteria as outlined in Article 6 of CACM and stakeholder views on the proposed NEMO designation process.

We would question why the NEMO is being designated in isolation from the other roles and responsibilities under I-SEM. The proposed approach may not therefore capture potential synergies from having one entity discharge all I-SEM market operator roles across the Day Ahead, Intra-Day, Balancing, Forward, Ancillary Services and Capacity Markets. Referring back to the important governance issue, we would also question how the NEMO will be compelled to represent I-SEM at EU level and what governance mechanism will be put in place locally to give the NEMO its mandate.

Our main concern therefore is how the NEMO designation criteria can be set to compel the NEMO to represent I-SEM at EU level (which is critical given the I-SEM design) and furthermore to provide a wider market operator role, beyond the day ahead and intraday market, to realise synergies beneficial to the I-SEM consumer. We suggest that this be given careful scrutiny from a procurement and legal perspective.

5. Response to consultation questions

Do you agree that the TSOs should carry out the role of delivery body for the capacity mechanism?

- Yes, but subject to concerns expressed about conflict of interest relating to ownership of EWIC and hence dependent upon the conflict being eliminated or robustly dealt with.
- The delivery body role should not extend to the design of the capacity mechanism (or its subsequent modification).

Are there are synergies and economies of scope from having a single entity perform the I-SEM market operator roles, i.e. day ahead and intra day, imbalance settlement and capacity settlement? If so, how would these lower costs to consumers?

- Given the small size of the all-island market we agree with the RA's focus on achieving synergies where possible.
- By having one entity discharge all I-SEM market operator roles, we believe that synergies can and should be achieved, including: cost savings associated with economies of scope; cost savings associated with economies of scale; and a reduction in transaction costs associated with interfacing with the market and meeting credit / collateral requirements.

Do you think there are conflicts of interest arising from the same entity performing the market operator and TSO roles in the I-SEM? If so how would these increase costs to consumers and what mitigation measure could be put in place to deal with these?

- The consultation paper considers the potential for conflicts of interest arising from the same entity performing the market operator and TSO roles in the I-SEM and provides examples on pages 22 and 23 to illustrate where such conflicts could arise. The examples provided are plausible and are by no means exhaustive. The potential conflict could materialise in a variety of ways which may not always be obvious or even deliberate and therefore it would be prudent to put in place appropriate mitigation measures.
- Potential conflicts as asset owner of EWIC should also be considered and eliminated or robustly managed.

- The effect may not just be related to “increased costs for consumers” but may increase barriers to competition and potential and perception are equally important as actual conflicts.
- The analytical framework proposed in the consultation paper to assess conflicts of interest and manage them under I-SEM may not address potential conflicts appropriately because of its limited focus on conflicts that translate into increased costs for consumers.
- It is important to clarify that the perception of potential conflict (whether exercised or not) is sufficient to distort competition and deter investment and should therefore be dealt with robustly.

Do you have any views on the RAs interpretation of the NEMO designation criteria?

- Our main concern is how the NEMO designation criteria can be set to compel the NEMO to represent I-SEM at EU level (which is critical given the I-SEM design) and furthermore to provide a wider market operator role, beyond the day ahead and intraday market, to realise synergies beneficial to the I-SEM consumer. We suggest that this be given careful scrutiny from a procurement and legal perspective.

Do you have any views on the RAs proposed NEMO designation process?

- As above, it is difficult to see how, as proposed, the NEMO designation process can ensure the interests of I-SEM are adequately represented at EU level and that facilitates a single NEMO providing a wider range of market operator roles under I-SEM to realise important synergies for the benefit of the I-SEM consumer.