Power NI Energy Limited
Power Procurement Business (PPB)

I-SEM Detailed Design

Roles and Responsibilities Consultation Paper

SEM-15-016

Response by Power NI Energy (PPB)

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Power Procurement Business

Introduction

PPB welcomes the Regulatory Authorities engagement with market participants in the development of the I-SEM and welcomes the opportunity to respond to the consultation on I-SEM Roles and Responsibilities.

General Comments

We note the comments on the importance that key entities responsible for the development of the CACM processes for the I-SEM are designated as soon as possible in order to avoid delayed implementation and to ensure that the interests of I-SEM consumers and market participants are represented at EU level in the development of rules, methodologies and T&Cs of the DAM and IDM markets. However, in the context that the NEMO role is not monopolist, it is unclear how such obligations are to be imposed on the NEMO(s). Is this to be under-pinned by a licence obligation or is it to be part of the designation criteria?

Furthermore, it will be necessary to establish appropriate governance arrangements around the obligation to "represent the I-SEM" such that the entity with the obligation can capture and represent I-SEM views. This would also need to consider how the NEMO will comply with such an obligation where there are conflicting views as to what is best for the I-SEM.

Need to minimise the cost of participation in the I-SEM

The cost of participating in the I-SEM markets is a key concern for market participants and it should similarly be a concern for the RAs and the SEMC given their obligations to protect the interests of consumers. The cost of maintaining credit support in the current SEM market is high and the design of the I-SEM with multiple shorter term markets could result in the requirement for interfaces with multiple settlement bodies requiring even more collateral. This is further compounded by the proposed CRM that will likely require generators to provide credit support.

It is therefore imperative that every effort is made to maximise the synergy value across all the markets (Forward, DAM IDM, BM, CRM and DS3) to seek to have a single interface that both provides efficient market interface costs and can enable credit support cost netting to minimise such costs for participants in I-SEM. However, while this could easily be specified if the market were designed with a single market operator, the requirement in CACM to allow for multiple NEMOs makes such an outcome more uncertain and difficult to deliver. In the context of potentially multiple NEMOs, it is not

clear whether there would be any barrier to the selection and appointment of one of the NEMOs to undertake a wider and local I-SEM market enhancing role. However, if general participation and credit costs are to be minimised, some viable approach must be found.

Description of the SEM and I-SEM Operational Roles and Functions

The descriptions of the various market roles and responsibilities under both the existing SEM arrangements (sections 3.1/3.2) and in the I-SEM (section 3.3) fail to recognise the role of Intermediaries who have been, and will continue to be, significant participants in the wholesale markets, particularly in relation to wind participation.

In relation to the changes to roles for I-SEM as set out in Table 2 of the consultation paper, the changes identified for Generators and Suppliers indicate that there will be new obligations to participate and be balance responsible. However, the only mandated market is the Balancing Market and it is not readily apparent how these entities will be obligated to be balance responsible when in reality, they could choose to ignore all the markets and just accept the balancing exposure. Hence there isn't really any balancing responsibility obligation as such but more that balance responsibility may be incentivised by the pricing in the BM.

The definition of the NEMO is written as though it is a monopolist role when it is clear from the CACM and from elsewhere in the consultation paper that there can be multiple NEMOs providing services in each bidding zone.

The definition of the Balancing Market Operator (BMO) function indicates it includes "*submission of incremental and decremental prices*". We do not understand what role the BMO has in submitting INCs/DECs. It will be receiving INCs and DECs as the bids/offers to enable it to balance the market but we do not understand what role it has in submitting these. Is this contemplating cross-border balancing?

It is also unclear if the CRM Settlement Body is just settling the initial redistribution of capacity auction revenues from Suppliers to Generators or whether the role (as we would expect) also involves the collection of any payments from generators under the ROs and the subsequent redistribution of such funds to Suppliers over the course of the term of the ROs.

Assignment of I-SEM Operational Roles and Functions

PPB agrees that the BMO role is a TSO function.

We note the role of BM settlement could be performed by the TSO or a market operator. As we outlined in our initial comments above, we consider it would be preferable for this role to be performed by a single common counter-party who is also responsible for all the other market settlement roles which would maximise the synergy benefit and minimise participation costs in I-SEM. If this is not possible then the scope to capture the same "netting" benefit through alternate means, e.g. through some form of mandated multi-lateral netting obligation, must be fully investigated.

In relation to the CRM Delivery role, we would have concerns if the TSOs had any conflict of interest. This would be a real issue if, for example, Eirgrid as owners of the East-West Interconnector were competing in the CRM Auctions. We would also be concerned if the scope of the role were to extend beyond merely running the auctions, and it must be clear that the scope must not creep into any aspect of the CRM design or the auction process design. The role of running the auction process could easily be performed by anyone and the argument that it naturally sits with the TSO because they have a role in determining the capacity requirement is not particularly compelling. We have a further concern with the statement that the CRM delivery role would include acting as the contractual counterparty. This could create an issue in relation to credit/collateral and as noted above, it would be preferable for all such arrangements to be capable of netting to minimise collateral costs for participants.

Again we consider that the capacity settlement role must be conducted in a manner that enables the credit netting synergy to be captured. In terms of the settlement of the ROs, there is likely to be more operational synergy with settlement of forward market CfDs than with settlement of the Balancing Market.

It is likely that the netting of credit requirements under forward market contracts with those required in the short-term markets will provide the most synergy and netting benefit. Hence a mechanism must be found to enable such netting benefits to be captured. In relation to FTRs, the consultation paper indicates potentially competing responsibility for FTR settlement. On page 13 it indicates that settlement is the responsibility of the Single Allocation Platform whereas in section 4.2, it indicates that it is the Interconnector owners who are responsible for settlement. This needs to be

clarified and again the scope to ensure credit netting synergies are captured must be investigated.

Synergies and Conflicts of Interest

We have a concern that the reference to "*mitigating conflicts of interests where they lead to increased consumer costs*" indicates too narrow a focus. While this may appear to be a tangible test, we are concerned that the conflicts of interests, or the potential for there to be conflicts, could be a barrier to competition that may not initially be as evident as increasing costs to consumers in the short term but which could have a greater effect on the long term efficient functioning of the market and on efficient investment in the market. The relevance of DECC's considerations for the GB market to the prevailing situation in the I-SEM is not obvious and the focus must be on what will provide the best outcome for the I-SEM. We consider it would be much simpler to start from the premise of seeking to avoid conflicts of interest where possible such that mitigation measures will only be required where there is no alternative.

We note the comments that the role of the East-West Interconnector will be considered as part of the TSO certification process, including its role in the ancillary services market. This is a critical issue and must not just be something considered privately by the RAs but must be subject to open and transparent consultation.

We are also concerned at the proposal to wait until after decisions have been taken on the roles and responsibilities before consulting on synergies and conflicts of interest. We consider the decisions on roles and responsibilities should be made taking account of the synergies and conflicts to ensure the decision maximises synergies and minimises scope for conflicts of interest. This will be an easier process to build in as part of the decision rather than seeking to retrofit it after having made the initial decision.

Responses to the Specific Questions raised in the Consultation Paper

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

We accept that this role could be performed by the TSOs, although as outlined above this is subject to there being no conflict of interest and the scope not creeping beyond that described (i.e just hosting the auctions).

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?

The I-SEM is a small market and hence there is a natural scale disbenefit. We therefore consider that every opportunity to minimise participation costs must be harvested to constrain the impact for consumers.

Having one entity performing the market operator roles would create an efficient interface to the markets for participants which should result in lower system establishment and ongoing participation costs. Further it would provide scope for more efficient management of credit support costs by maximising the scope to aggregate and net the requirement for collateral across all the markets. It would also be beneficial if this included the Forward Market transactions since they tend to offset requirements in the spot markets.

If it is not possible to have a single entity performing the market operator roles the SEMC should explore whether the same effect could be achieved by an alternative method e.g. via some form of multi-lateral netting arrangement.

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?

As already identified above, we consider there are potential conflicts of interest, particularly where Eirgrid own EWIC and if Eirgrid were competing for the provision of services (e.g. in the CRM or for DS3 services).

We also highlighted our concern that the effect may not just be related to “increased costs for consumers” but may extend more subtly to increased barriers to competition that are less obvious in the short term and which may not initially increase prices for consumers (an example could be predatory

pricing for DS services). It is also important to recognise that it is not just the ability or incentive to act on a conflict that creates a problem but that the potential and perception are equally as important as actual conflicts.

As already stated, we consider it would be preferable to seek to avoid conflicts in the first instance rather than seeking to add mitigation measures. The I-SEM already suffers from significant market power issues and overlaying further mitigation measures only adds further complexity whereas it would be preferable if they could be avoided.

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

The interpretation of the NEMO designation criteria seems generally appropriate. However, our primary concern relates to how criteria can be set to require the NEMO to, for example, represent I-SEM in wider EU context/discussions, and be required to provide additional services beyond DAM/IDM such as BM settlement, Collateral netting, etc.

This is particularly important given the NEMO is not "procured" in any traditional sense but instead the criteria just sets a minimum requirements hurdle above which any number of NEMOs can exist. It isn't obvious that all NEMOS could be required to provide all the services that may be beneficial for the I-SEM and whether conferring any additional roles to one NEMO could be construed by others/the EU as conferring an unfair advantage to the "annointed" one.

As expressed earlier, we consider the best solution for the I-SEM is to have a single entity performing all the market operator and settlement roles and strongly representing the interests of I-SEM in the wider EU forums. Hence it would be desirable if this were reflected in the criteria. We note an attempt to cover this on page 30 under the Criterion *"fair and non-discriminatory application of criteria".* However we are concerned that this could be challenged and it would be helpful to understand whether any legal opinion has been obtained to ensure that for example requiring that the NEMO must operate and settle other I-SEM market roles in addition to the DAM and IDM is legally robust and satisfies the CACM Article 6 Designation Criteria that requires that "*competition between NEMOs is organised in a fair and non-discriminatory manner*".

We have a similar concern in relation to the need for the NEMO to represent the I-SEM's interests in wider EU forums. Again this would be relatively easy where there is a monopoly role and hence one is being appointed under

Article 5. However, it is less obvious how this obligation can be imposed when the designation occurs under Article 4 and the criteria are a hurdle above which any party who meets the criteria must be designated.

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

As we have already stated above, we have difficulty reconciling “designation” in the circumstance where the I-SEM would be best served by a NEMO that is appointed to seek the best outcomes for the I-SEM in its liaisons in wider EU forums and where maximisation of synergies is sought by having a single entity performing all the market operator roles. This does not appear to sit easily with the CACM that, under designation via Article 4, sets a criteria hurdle for NEMOs above which any party must be designated thereby allowing multiple NEMOs.

We consider it to be essential to capture the synergy benefits for the I-SEM and to have proper I-SEM representation in the forums yet it is unclear how such governance can be established and maintained when designation is conducted in compliance with Article 4 of the CACM.