Single Electricity Market

Proposed Conditions of Market Operator Licences

Second Consultation

26th February 2007

AIP/SEM/07/17

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1. INTRODUCTION

1.1 General

In September 2006, the Commission and Energy Regulation (CER) and Northern Ireland Authority for Energy Regulation (NIAER) jointly referred to as the Regulatory Authorities (RAs) published a consultation setting out the conditions of licences proposed to apply to the parties carrying out the role of SEM Operator (referred to as "Market Operator") in Northern Ireland and the Republic of Ireland under the SEM. Furthermore, in January 2007, the RAs published a further consultation setting out proposals for two additional conditions (12 and 12A) governing the independence of the Northern Ireland MO activity which mirrored equivalent conditions in the draft SO licences which were also published for consultation in January.

Seven responses to the consultation were received to the September consultation. Furthermore in addition to one specific response to the January consultation on conditions 12 and 12A, a number of comments on these conditions were also received as part of the response to the consultation on system operator licences which was published at the same time.

In light of these responses, discussions with the licensees (SONI and Eirgrid) and further consideration by the RAs of the appropriate content of these conditions, particularly in light of the development of the draft system operator licences and SEM legislation, the RAs have updated the draft MO licences. This document sets out the background to these updated drafts and invites comments on the new proposed licence conditions.

1.2 Request for Comments

The Regulatory Authorities request comment from interested parties in relation to the proposed conditions of the MO Licences that are set out in this paper.

The Regulatory Authorities intend and prefer to publish all comments received, but are prepared to facilitate those respondents that wish that certain sections of their submission remain confidential. Accordingly, respondents that so wish should submit these sections in an appendix that is clearly marked "confidential".

Comments on this paper should be forwarded, preferably in electronic form, to Donna Hamill at:

donna.hamill@ofregni.gov.uk

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Queens House
14 Queen Street
Belfast
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The deadline for the receipt of comments is 1700h on Friday 30th March 2007.

2. REVIEW OF COMMENTS RECEIVED

2.1 General

This section sets out the principal comments raised by respondents to the September 2006 consultation on MO licences and the January 2007 consultation on business separation conditions insofar as they relate to the NI MO licence. It also sets out the RAs' response to these principal comments. Not all comments received are discussed explicitly in this document, but all have been reviewed and taken into account in developing the revised draft licences accompanying this consultation paper.

The RAs also note that the licence conditions remain under review in the light of further changes in legislation applying to the MO licensee in the Republic of Ireland.

2.2 Identity of MO

Respondents' views

One respondent stated that they were of the opinion that there should be a single MO, that the role should be put out to international competitive tender, and ownership of the MO should be independent of the market participants.They also viewed the appointment of the existing SO's to the MO role as being a potential barrier to a transparent and competitive Market.

Another respondent stated that there remained uncertainty over the business separation arrangements in NI. In conjunction with another respondent their view was that business separation obligations should be equally robust in both jurisdictions. Another respondent stated that it would be helpful for NIAER to share plans for the separation of SONI from the Viridian Group with market participants.

RAs' views

The decision that Eirgrid and SONI should carry out the role of market operator was announced on 10th June 2005 in the SEM High Level Design Decision Paper following a process of discussions with Industry in general and Eirgrid and SONI in particular. The establishment of the MO activity has moved on substantially since this time, and the RAs are of the view that that it is neither appropriate nor necessary to revisit the decision to appoint SONI and Eirgrid to carry out the MO role at this time. It is the RAs view that there are not any substantial conflicts in

the SOs carrying out the MO activity and instead there are a number of synergies to be derived from having the SO and MO activities in the same organisation.

Insofar as business separation arrangements are concerned, the RAs note that in November 2006, the proposed SEM related legislation in Northern Ireland was published for consultation by the Department of Enterprise, Trade and Investment. As explained in the recent consultation paper on the SEM legal framework[1], whilst it is anticipated that SEM legislation in NI will provide for the divestment of an appropriately functioning system operator activity, and that that the principal structural changes to licences and contracts will be made for initial SEM implementation, it is not anticipated that actual divestment will take place by November 2007. Instead, it is currently expected that this separation will take place by November 2008.

A further discussion of the comments and issues emerging from responses to the business separation consultation (i.e. the January 2007 consultation on proposed conditions 12 and 12A) is included in section 2.7 below.

2.3 Structure of MO function

Respondents' views

One respondent expressed reservations over the structure of the contractual joint venture, stating that not having a single legal entity could potentially cause problems in attributing liabilities. They also requested further information on how disputes between the two system operators acting in their capacity as market operator would be resolved.

Another respondent was not clear how the "SMO" activity would function, for example who the staff would be employed by; how the entity would function and were the business would be located. They also inquired as to how market clearing systems would be upgraded, how all-island regulation would operate and why the draft SONI licence included a dividend condition for a non-profit making entity. They also requested information on where accounts would be prepared, where taxes would be paid etc.

A further respondent stated that as the MOA did not require regulatory approval, the licensees would be the only means of guaranteeing protection of the unified obligations. The were of the view that it was inappropriate to depend on such a

[1] Enduring licensing and contractual framework applying under the SEM and associated changes for EU Directive compliance in Northern Ireland. 06/02/07.

document to align disparate licence obligations into a single operation with unity of purpose. Another respondent stated that in their view regulatory agreement should be required to change the MOA and, in particular that this should require joint regulatory agreement.

One respondent stated that whilst it had been agreed that the function of the SMO would be carried out by the joint efforts of two entities operating in their separate jurisdictions, the operation of this role should be as if it is being carried out by a single entity in every respect and that this needed to be reflected in the draft licences.

RAs' views

It is the view of the RAs that the contractual joint venture structure should not give rise to problems in attributing liabilities. The principal reason for this is that where there is more than one company undertaking the MO role under the Trading and Settlement Code, both will be jointly and severally liable for the responsibilities of the MO under the Code. Paragraph 2.84B of the recently published draft version 1.2 of the Trading and Settlement Code (TSC) refers.

The fact that both MO licensees will be jointly and severally liable for carrying out the functions of the MO under the TSC reflects the fact that even where disputes arise between the two MOs, each continues to face a licence and contractual obligation to discharge the TSC responsibilities placed on the MO function. Hence, the existence of the joint venture structure does not dilute the obligations to market participants even in the event of a dispute arising. Where disputes do arise, in order to ensure that there is a means for them to be resolved in a manner that is binding upon the two market operators, the licence conditions relating to the establishment of the Market Operator Agreement contain the requirement that disputes between the two licensees are referred to the RAs for binding determination.

Under this arrangement, the function of the MOA is not to set out the way in which the MO function interacts with market participants. Instead, these matters should be set out in the Trading and Settlement Code with additional obligations being imposed through licence and statutory obligations. The purpose of the MOA is for the MO licensees to set out matters as between themselves which are needed for them to be able to comply with their statutory, licence and contractual obligations. The RAs are of the view that (except in the event of a dispute) it is principally the responsibility of the MOs to determine how they will work to deliver these obligations. Hence, if there is a specific requirement on the MOs to carry

out an activity in a particular manner, this should be reflected in the TSC and/or licences. How the MOs work together to meet these requirements is principally a matter for the MOs to organise and the way in which they elect to do this does not detract from their obligation to meet the requirement. On this basis, the RAs continue to be of the view that changes to the MOA do not need to be agreed by the RAs.

Insofar as the single nature of the SMO activity is concerned, the draft MO licences published in September did include the following obligations:

Condition 17 Paragraph 5 of SONI's draft MO licence:

"The Licensee shall, in conjunction with the Republic of Ireland Market Operator Licensee, ensure that persons who are a party to the Single Electricity Market Trading and Settlement Code or who wish to become a party to the Single Electricity Market Trading and Settlement Code have, to the extent that is reasonably practicable, a single point of contact when interfacing with the Single Market Operation Business."

Condition 3 Paragraph 6 of Eirgrid's draft MO licence:

"The Licensee shall, in conjunction with the Northern Ireland Market Operator Licensee, ensure that persons who are a party to the Single Electricity Market Trading and Settlement Code or who wish to become a party to the Single Electricity Market Trading and Settlement Code have, to the extent that is reasonably practicable, a single point of contact when interfacing with the Single Market Operation Business."

Whilst this is not a particularly strong obligation to ensure that the SMO activity is carried out as a "single" activity, the RAs took the view that in developing the MO licences, it was unnecessary to explicitly impose a stronger obligation in this regard. If respondents have further views on this issue, then they are encouraged to put forward additional specific proposals in response to this consultation.

2.4 Structure of licences

Respondents' views

One respondent stated that despite the joint SONI and EirGrid activity in providing the Single Market Operator function for SEM and repeated stressing that market participants will be presented with a single market entity, the layout and content of the two licences suggested their independent development and

undermined confidence that the envisaged unity of the SMO will be delivered. Thus, whilst they understood that interlocking of the two operators is intended to be seamless, the proposed Licences did not demonstrate the degree of harmonisation that they expected in documents designed to deliver a joint service. They went on to state that their expectation would be that from the outset all relevant documentation would align – referring to the respective MO licenses, the ordering of sections and the definition of terms - with this commitment.

RAs' views

In developing the MO licences for each of the two MO licensees, the RAs have taken the approach of structuring the licences in a manner which is consistent with the general approach to licensing in each particular jurisdiction. Hence, the general scope and content of the proposed SONI MO licence is based upon the general approach to NI electricity licensing and the scope and content of the Eirgrid MO licence is based upon the general approach to ROI licensing. This has led to the two licences containing different licence conditions (in terms of scope, ordering etc.), but means that each licence is aligned more generally with other electricity licences in its own jurisdiction and is more consistent with the legislation underpinning the licensing arrangements in each separate jurisdiction.

The RAs also note that whilst the differing legislative structures in the two jurisdictions will necessarily give rise to differing licence structures, in relation to the key operational functions of the MOs (such as the MOA and TSC conditions) the licence drafting is identical.

2.5 Performance of the MO

Respondents' views

Several respondents commented on the issue of performance criteria. One stated that it was not appropriate for the MOs to set their own performance criteria (even if they were subject to regulatory approval). Instead they were of the view that market participants – the customers of the MO – should set the criteria or that alternatively they should be set by RAs' advisers. Another agreed that the MOS should not set their own criteria and thought that a single set of criteria should be developed by the RAs with MO input and published for consultation. A third respondent also stated that the MOs' performance criteria should be set by the RAs through a consultative process with market participants. They also suggested that the MO should be required to provide regular reports to the RAs on a number of specific performance measures. A fourth respondent

was also of the view that the MOs should not set, measure and report on performance criteria, and that instead market participants should be involved in this process from initial design through to evaluation of performance. They also noted that there was a potential mismatch between Condition 19 of Eirgrid's licence and the TSC in which the former implied that certain compliance costs would fall to the licensee whereas the other implied that MO costs would be met market participants. More generally they queried how material non-performance of an organisation that did not have any assets would be addressed, stating that ultimately only licence revocation could deliver the necessary incentives.

RAs' views

The RAs accept that it would be appropriate to adopt a more objective process for setting the performance criteria than that set out in the September consultation. To that end, the RAs have amended the proposed conditions to provide flexibility for the RAs to consult or for the RAs to require the licensees to consult on the proposed criteria, and for the criteria to be amended in line with and decision by the RAs. It is also implicitly the case that the RAs may also choose to consult upon the performance reports of the Market Operators.

Specific Proposals for price controls for the Market Operators will be the subject of a separate consultation in due course.

2.6 Other Comments

A number of other specific comments were raised. These are set out below with the RAs' views included in italics in each case:

- Any additional licence obligations relating to the market monitoring activity should be confined to information provision and should not confer upon the MO any interpretive or investigative activities.

  The RAs concur with this approach and do not propose to give the MOs licence obligations requiring interpretive or investigative activities in this regard.

- The licences should be granted for the same term in order for the framework plan to have one SO and one MO meaningful.

  The RAs do not agree that this is necessary. It is noted that the term of the NI licences is not the same as the duration of the licence. Unless the licence is revoked, the licence is effectively granted in perpetuity unless

the Authority elects to determine the licence, in which case the licence continues for a further 25 years after the determination. Give that a notice to determine the licence cannot be issued until 10 years after the grant of the licence, this means that (unless revoked) the NI MO licence will apply for a minimum of 35 years.

- The Development plan should be subject to industry consultation

  The RAs' accept that this may be appropriate but are of the view that it can be accommodated under the existing drafting.

- The MO should have an obligation to notify market participants of any major changes in IT platforms etc.

  The RAs' accept that market participants do need to be kept abreast of such developments. It is anticipated that the Development plan would (if required to be produced) contain this sort of information. This issue is also being considered in the development of the next draft of the Trading and Settlement Code and arrangements for appropriate involvement and notification of market participants will be delivered through a combination of these TSC provisions and the Development plan.

- The reasonable endeavours obligations in relation to restrictions on the use of certain information are insufficient. Furthermore independent audits of the MOs' processes and activities should be a requirement.

  The reasonable endeavours obligations applying in relation to protected information apply only to the information that affiliates or related undertakings already hold (or may subsequently receive subject to the agreement of the person to whom the information relates). The RAs continue to be of the view that the confidentiality provisions remain broadly appropriate, although a number of changes have been made to further harmonise the conditions in the two licences.

- SONI, as well as Eirgrid should have a code of conduct

  As such codes of conduct are not currently required by conditions of NI licences, the RAs do not agree that it is necessary to incorporate such a condition into the SONI MO licence.

- A condition relating to Health and Safety is unnecessary in the MO licence as the MO will be subject to statutory obligations in this regard and its

employees will not be engaged in work on electricity plant, and hence it will not have common health and safety concerns with other licensees.

The RAs agree that this is not needed in the MO licence for SONI.

- Rather than simply have an obligation to facilitate participation in a manner that will neither prevent nor restrict competition, the SMO should be obliged proactively to promote and encourage competition in the SEM.

  The RAs do not agree that it would be appropriate for a such a positive obligation to be placed directly on the MO as it may, for example, require the MO to facilitate secondary markets etc. However, the objectives of the TSC (which continue to be kept under review as part of the ongoing development of the TSC) do include the promotion of competition as one of the code objectives.

2.7 January consultation on proposed conditions 12 and 12A

Respondents' views insofar as the comments related to MO licences

One respondent noted the proposal to permit SONI to remain as a wholly owned subsidiary of NIE for initial SEM implementation. They were concerned that not only was there no firm timetable for SONI separation from NIE, but also that it was not even clear to them that the need for SONI separation had been fully accepted. They suggested that a firm undertaking on SONI divestment should be given by NIAER and that a timetable for divestment should be published.

Another respondent stated that it was appropriate for the activity of distribution to be included in the list of "Associated Businesses" in the draft condition 12.

A third respondent proposed changes to make it clear that decisions relating to the operation of the SEM Trading and Settlement System should *only* be taken by those engaged in the management and operation of the Market Operation Activity. They stated that that in order to avoid inadvertent transfer of information between staff (for example in canteens etc.) there should be full separation of premises and access by Associated Businesses. They also stated that the drafting should be more prescriptive on the minimum time between leaving the Market Operator Activity and joining an Associated Business. The same respondent also raised the issue of branding, suggesting that a new condition should be included to prevent the market operator from using any form of branding that was connected with an Associated Business. Finally they raised a number of comments on the compliance plan. First, that should be published on

the web and should include contact information for the Compliance Manager, second that the plan should always be available, rather than “from time to time” and finally that an obligation should be placed on the Compliance Manager to attend, and copy minutes of, any meetings between the Market Operator Activity and any Associated Business.

RAs’ views

The RAs confirm that the need for SONI divestment is accepted. Whilst SEM legislation in NI provides for the divestment of an appropriately functioning system operator activity, and it is intended that the principal structural changes to licences and contracts will be made for initial SEM implementation, it is not anticipated that actual divestment will take place by November 2007. Instead, it is currently expected that this separation will take place by November 2008.

The RAs accept that it is not necessary for the activity of distribution to be included in the list of Associated Businesses.

The RAs agree with the comments raised in relation to decision making and staff transfers and have made drafting changes accordingly. Insofar as branding is concerned, the RAs are of the view that any such restrictions should apply to competitive businesses and not monopoly businesses and consequently that it is appropriate to address these issues in the context of generation and supply licences. In relation to the specific comments on compliance, the RAs are of the view that the current provisions are sufficiently broad in scope to accommodate the suggestions put forward by the respondent and that the detail of such matters should be addressed when the compliance arrangements are developed in more detail

3. OTHER CHANGES

The RAs note that in addition to changes made in response to comments on the consultation, a number of other changes been made to the MO licences following the initial consultation in September. These changes include amendments to reflect updated thinking in light of the development of SEM legislation and other licences such as the system operator licences and discussions with licensees and other industry participants as part of the ongoing development of the SEM. The principal changes include:

- Updates to definitions.
- An update to the accounting obligations in SONI's licence to reflect more recent developments in NI licences in general.
- A general update to the provisions relating to the MOA which have been updated in light of further thinking when developing the equivalent provisions for the System Operator Agreement in the system operator licences.
- Updates to the TSC objectives in light of a further consideration of these as part of the development of the TSC.
- The removal of the possible PSO condition in Eirgrid's licence to reflect the fact that it is not intended that the MO would deal with PSOs.
- Some further harmonisation between the two licences.

APPENDICES: SECOND DRAFT MO LICENCES

Please see accompanying documents.