

Response from Viridian Power and Energy

To

SEM

Proposed Conditions of Market Operator Licences

First Consultation Paper

26th October 2006



Introduction

VP&E note the consultation on the SEM proposed conditions of Market Operator Licences as a necessary part of the SEM implementation.

It is critical, in the discharging of their duties, that the responsibilities of the Market Operator are clearly defined and measurable. It should also be clear what the liabilities and penalties of underperformance are and, in tandem with that, what the incentives are for delivery. Appropriately governed monitoring processes are necessary in order to deliver full transparency and accountability of the Market Operator function.

VP&E have expressed reservations over the structure of the contractual joint venture in that not having a single legal entity could potentially cause problems in attributing liabilities. Perhaps the licence should allow for a single legal entity in the future if the joint venture proves difficult in this respect. Does the licence provide for the function of the Market Operator to be restructured as a single legal entity?

Conflict of interest

It is in the interests of the whole market that the Market Operator's processes are both robust and cost effective. The Market Operator's roles and responsibilities in running the market, as defined by the Regulatory Authorities, should be used to define a comprehensive list of criteria against which their performance can be measured. VP&E consider that it is inappropriate that the Market Operator should determine their own performance criteria, even in the first instance, given their obvious conflict of interest.

Criteria for and measurement of the performance of the Market Operator

The Regulatory Authorities would be best placed to produce the Market Operator's performance criteria through a consultative process with the market participants. We suggest that independent consultancy is employed and charged with the role of investigating how this could be best done, with cognisance of how this has been achieved in other jurisdictions. Independent setting of performance criteria, and subsequent measurement and monitoring is essential for confidence in the Market Operator.

VP&E suggest that the license should require the Market Operator to provide regular reports to the Regulatory Authorities on the performance of the market operator criteria including measures of:

- Timely delivery of information
- Prudent management of cash and debt
- Staff and other overhead costs
- Other performance criteria based on industry best practise

Liabilities, incentives and penalties

Associated with the performance criteria (and its measurement) are the liabilities, penalties and incentives. It is not in the interests of the market to have a Market Operator that would either fail in the discharging of its' duties or fail as a company. At the same time however it is important that there is clear accountability. Tight controls over its' functioning are therefore necessary along with clear incentives for delivery, and clear penalties for failure of delivery.

The contractual joint venture mechanism could in theory result in a scenario where a liability could become an issue of disagreement between the two license holders. VP&E would welcome further information on how disputes between the two system operators, acting in their capacity as the market operator, will be resolved.

Since network companies are required to report on the performance of their respective networks, and incentivised accordingly, Market Operators should carry similar obligations with respect to their Market Operator function and be subject to an incentives/penalties regime.

VP&E suggest that a well constructed incentives and penalty scheme should be facilitated by the license but that the details should be defined by the regulatory authorities and altered from time to time depending on prevailing circumstances.