

Proposed Conditions of Market Operator Licences

AIP/SEM/159/06

Response by Airtricity

Overview

In approaching the review of the draft SMO licences accompanying AIP/SEM/159/06, our general expectation was that as much as possible we should read the two documents as if they referred to a single entity currently operating in two jurisdictions but attempting to harmonize its activities under the same umbrella. Unfortunately this is not the impression given and we are concerned that the provision of a single seamless SMO for market participants, as envisaged by the Trading and Settlement Code, may be jeopardised by elements of these draft licences.

Our response develops from this issue but also explores our other concerns – the lack of provisions making it obligatory on the SMO, as the central administrator of the market, to promote competition in congruence with generally accepted economic practice and with European Union directives (see eg Article 3 of Directive 96/92/EC which stresses operating electricity undertakings “with a view to achieving a competitive market”). Other concerns relate to the Market Operator Agreement, the performance measurement process and finally the issue of ultimate liability and accountability.

Harmonisation of Document Sections and Terms

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 documents suggests their independent development and undermines confidence that the envisaged unity of the SMO will be delivered. Thus, whilst we understand that interlocking of the two operators is intended to be seamless, or at least functionally to be so in order to facilitate a transparent interface for participants, the proposed Licences do not demonstrate the degree of harmonisation that we would have expected in documents designed to deliver a this joint service.

Ordering of Conditions

Based on this underlying hypothesis, our 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. In reviewing the draft licence documents, although effort has obviously been made to achieve this alignment in the definition of some terms, it has not extended to the overall structure of the documents, which obstructs comparison of the two in terms of the obligations placed on each organisation and the level of commitment required. If alignment cannot be achieved in the exact wording of the contents, because of disparities in

legislation and custom between the two jurisdictions of NI and ROI, we would at least expect alignment of structure and content.

To illustrate, the table below shows the ordering of the various sections in the two licences. For convenience the SONI draft licence has been used as the reference document, although there is no particular significance to this approach. The important thing is that consistency will facilitate parallel reading and easier comparison of the balance of obligation and burden of responsibility between the two organisations; advancing the perception of a Single Market Operator as a single entity;

Heading	SONI	EirGrid
Interpretation and Construction	Condition 1	Condition 1
Preparation of Accounts	Condition 2	Condition 13 (implied)
Availability of Resources and Undertaking of Ultimate Controller	Condition 3	N/A
Restriction of Dividends	Condition 4	N/A
Prohibition of Cross-Subsidiaries	Condition 5	Condition 14
Health and Safety of Employees	Condition 6	Condition 21
Provision of Information to the Authority	Condition 7	Condition 17
Payment of Fees	Condition 8	
Disposal of Relevant Market Assets	Condition 9	Condition 7
Restriction of Dealings with Assets	Condition 10	Condition 6
Restriction of Use of Certain Information	Condition 11	Condition 12
Independence of the Market Operation Activity	Condition 12	Condition 13
Ownership of the Market Operation Activity	Condition 12A	N/A
Prohibited Activities	Condition 13	Condition 11
Security Arrangements	Condition 14	N/A
Non-Discrimination	Condition 15	Condition 9
Market Operator Agreement	Condition 16	Condition 2
Single Electricity Market Trading and Settlement Code	Condition 17	Condition 3
Market System Development Plan	Condition 18	Condition 4
Performance of the Single Market Operation Business	Condition 19	Condition 10
System Operator Agreement	Condition 20	Condition 8
Procurement of Assets	Condition 21	Condition 5
Charging and Revenue Restriction	Condition 22	N/A
Public Service Obligation	N/A	Condition 15
Payment of Levy	N/A	Condition 16
Code of Conduct	N/A	Condition 18
Compliance with Laws and Directions	N/A	Condition 19
Environment	N/A	Condition 20

Note: The term 'N/A' indicates sections in one licence that do not have a corollary in the other. Also, the headings are generally as found on the draft SONI licence document and these may not exactly match sections mapped from the Eirgrid version. Mapping the sections is based on either minor wordings differences (such as EirGrid

licence Condition 13 – Separate Accounts for Separate Businesses), extra terms (such as EirGrid licence Condition 5 – Procurement of Assets *and Services*) or implied inclusion in the content (such as in EirGrid licence condition 13).

This cursory overview demonstrates the independent approach to development of these licences and raises a question as to whether the Licences will indeed deliver on the principle of providing the equivalence of obligation necessary to facilitate delivery of a unitary Single Market Operator. We would suggest that the conditions, where they exist in both draft licences, be ordered similarly so that a reference to a condition (as currently holds for Condition 1 in both draft licences) will for all intents and purposes be referring to the same issue, and that special conditions for the individual Parties are placed at the end of the documents.

Definition of Terms

As previously mentioned, effort has been made to harmonize the definition of terms used. For example, the term *holding company* is defined in the respective draft licences as;

SONI	EirGrid
“has the meaning attributed to it at Article 4 of the Companies (Northern Ireland) Order 1986”	“means a holding company within the meaning of the Companies Acts, 1963 to 2005”

The reading and interpretation of these terms and comparison between the two draft licences is relatively straightforward.

However certain other terms need the same effort to be applied to them to enable easy comparison. To illustrate the term *affiliate* is defined respectively as;

SONI	EirGrid
“means, in relation to any person, any company which is a subsidiary of such person or a company of which such person is a subsidiary or a company which is another subsidiary of a company of which such a person is a subsidiary”	“in relation to the Licensee or any subsidiary of a holding company of the Licensee, means any holding company of the Licensee or any subsidiary of the Licensee or any subsidiary of a holding company of the Licensee”

The Eirgrid Licence defines relationship in terms of the Licensee, whereas the SONI Licence definition is generic even though the context relates only to the Licensee. Why can such common definitions not be aligned by having identical wording?

Proactive Approach to Competition

Conditions 17 (SONI) and 3 (EirGrid), paragraph 4(d) make the provision that the Licensees will facilitate participation in the market in such a manner that “neither prevent nor restrict competition”. The tone of this obligation, for the most central role in the SEM, is entirely passive; so long as the Parties in their role as SMO don’t actually hinder competition they are compliant. We strongly argue that the licences should obligate the SMO proactively to promote and encourage competition in the SEM as a means of ensuring efficiency and the delivery of positive benefits to the end

users of electricity in the whole island of Ireland. The organisational mindset and consequent behaviour engendered by a proactive obligation will deliver superior market results compared with a "do-nothing-wrong" obligation.

Market Operator Agreement

Whilst the Market Operator Agreement will exist to further the aim of having the two operators working as closely together as possible, this Agreement will not have priority over the Licences. Furthermore the MOA does not require regulatory approval which means that the Licences are the only means of guaranteeing protection of the unified SMO obligations. The MOA represents the means whereby the Licensees will implement their licence obligations and it is inappropriate to depend on such a document to align disparate licence obligations into a single operation with unity of purpose. An "agreement between the MO licensees", subject to the joint and several decisions of the Licensees, provides a much lower level of assurance to Participants.

Performance Measurement

Conditions 19 (SONI) and 10 (EirGrid) refer to the setting out of criteria for judging and the periodic assessment of the performance of the SMO.

Paragraph 1 states that "the Licensee shall ... submit ... a report setting out the performance criteria against which the performance of the Single Electricity Market Trading and Settlement System may be measured." Paragraph 3, "the Licensee shall ... periodically review the performance criteria." Paragraph 4, "the Licensee shall ... report annually on the performance of the Single Electricity Market Trading and Settlement System using the criteria specified ..."

In essence the Licensee shall conduct, end-to-end, all performance measurement processes, including designing, assessing and rating itself on the criteria it devised itself in the first instance. This is equivalent to rolling the functions of the legislature, the courts and the government into one; it totally negates the whole point of measuring performance and at best provides no incentive for good governance; at worst it encourages poor governance.

The performance of the Single Market Operation business impacts predominantly on Market Participants, who are both operationally and financially exposed to the actions of the SMO. For these reasons, we believe that market participants should be fully involved from the initial design of performance measurement criteria, through to evaluation of the SMO's actual performance; it will be highly prejudicial to exclude a substantive involvement of Participants in this process.

Liability

Condition 19 (EirGrid), paragraph 3 states that "Any costs associated with compliance with this Condition shall be the responsibility of the Licensee." On the other hand section 2.59 of the Trading and Settlement Code states that the costs of the SMO are to be recovered from market participants. Combining the two statements suggests the burden of SMO non-compliance will ultimately fall on Participants. Such a situation

is unacceptable. We would like an explicit provision in the licence that clarifies how material non-performance will be addressed; for an organisation without assets or alternative revenues, the ultimate sanction must be revocation of Licence to allow replacement by an organisation that can deliver. Without any credible sanction, there is no incentive for effective performance.

Conclusion

While it has been agreed that the function of SMO in the SEM will be carried out by the joint efforts of the two entities currently operating in their respective jurisdictions, we view the operation of this role being as if by a single entity in every respect, as paramount. This has not been reflected in the draft licences presented for consultation and we urge appropriate revision to remedy this.