



SEM Committee

Strategy Day

Information Paper

12 March 2010

SEM-10-013

1. Introduction

1.1 Paper Objective

The SEM Committee ('SEMC') met on 23 November 2009 for their annual Strategy Day. At this meeting progress on all ongoing SEM development work was discussed and reviewed. In addition, a number of further SEM policy areas were suggested for review over the medium term. Finally, a strategy aimed at consistent decision making was proposed to manage all SEM development work in the future. Following consideration it was subsequently decided to publish this paper on the strategy day discussions on future SEM work for the information of market participants and other interested parties.

This paper does not pre-empt the outcomes or policy decisions which may emerge from ongoing development work.

At their Strategy Day the SEMC discussed the overall performance of the SEM and ongoing development work within the context of the original SEM Objectives.

The SEMC wish to maintain the integrity of the SEM design as it develops and to ensure that the ability to meet the SEM Committee Objectives is not compromised due to a lack of coordinated policy making across various parallel regulatory workstreams. In order to mitigate this, the SEMC intend that in the medium term, proposed SEM decisions should be measured against the SEM Objectives and Design and contain a regulatory impact assessment. The intention is to enshrine the principle of regulatory consistency and continue to ensure a holistic approach to SEM decision making. The SEMC are of the view that the longer term strategic development of the SEM should be based on the SEM Objectives and the key external drivers impacting on the market including increased intermittent generation, increased interconnection and moves to regional integration of electricity market across Europe.

This information paper firstly reiterates the Objectives of the SEM. Next, the development work underway by the Regulatory Authorities ('RAs') as well as new areas for review is discussed and finally the framework for assessing SEM development work in the medium term¹ is outlined.

1.2 Background to SEM

On 1st November 2007 the Single Electricity Market (SEM) went live, commencing the trading of wholesale electricity in Ireland and Northern Ireland on an All-Island basis. The SEM Committee, the all-island decision making body for all SEM matters, was established on the same day .

¹ For the purposes of this paper, the medium term refers to the period until 2015/16.

1.3 Objectives

The SEM Legislation in Ireland and Northern Ireland provides for a primary SEM Objective and a number of supplementary objectives.

The key SEM Objectives as set out in the SEM Legislation are:

Competition and Consumers:

- The Principal Objective of the SEM is to protect the interests of consumers of electricity in Ireland and Northern Ireland supplied by authorised persons, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the sale or purchase of electricity through the Single Electricity Market.

Security of Supply:

- To secure that all reasonable demands for electricity in Ireland and Northern Ireland are met.
- To secure that authorised persons are able to finance the activities.

Sustainability:

- To secure a diverse viable and environmentally sustainable long-term energy supply in Ireland and Northern Ireland.
- To consider the effect on the environment in Ireland and Northern Ireland of the activities of authorised persons.
- To promote, where appropriate the use of energy from renewable energy sources.

Regulatory Consistency: ensure decisions are transparent, accountable, proportionate, consistent and targeted only at cases where action is needed.

2 Currently Proposed Medium Term Changes to SEM Design:

The SEM has been operating successfully since establishment and the SEM Committee in its 2008 Annual Report considered that thus far the market has worked well, delivered additional required capacity, including renewables, and is delivering fair and cost-reflective prices. The SEMC expects to publish their 2009 Annual Report in April 2010.

Ongoing development of SEM was always anticipated and there are at present a number of workstreams underway within the RAs under the aegis of the SEM Committee workplan to develop and adapt certain aspects of the SEM design so that it better meets the SEM Objectives and market developments. It should be noted that most of these work areas have not been completed and as such their results and recommendations cannot be pre-empted. These workstreams are briefly summarised below and a number of consultation papers relating to them have already been published by the SEMC.

2.1 Ongoing SEM Development Projects

The below table summarises the current development projects underway in the SEM:

Title	SEM Issues Addressed	Consultation	SEMC Decision expected	Potential Implementation of policy
Dispatch and Scheduling Paper	<ul style="list-style-type: none"> • Allocation of Infra marginal Rent • Meaning of Deemed Firm Access • Dispatch Principles, including Priority Dispatch & Tie Breaks • Treatment of Variable Price Takers • Determination of SMP when Demand is met by Price Takers • Quantity of Generation Paid Price Floor 	July 2009 (Ref: SEM/09/073)	2010	2011 -2012 Follow up work plans and consultations on specific modification proposals required
SEM Regional Integration Congestion Management Guidelines compliance East / West Interconnector	<ul style="list-style-type: none"> • Co-ordinated explicit auctions across IC within France, UK, Ireland region • Intra Day Trading solution for SEM • Market Coupling through day ahead price mechanism to be explored • SO-SO Trades coordination regionally • Barriers to Trade across regional ICs addressed with regional regulators 	September 2009 (ref: SEM 09/096)	March 2010 (ref: SEM 10/011)	Follow up work plans and consultations on specific proposals required Focus in 2010 on explicit auctions, intraday trading rules and day ahead mechanism study as well as work in regions Mid 2011 for final decisions on changes to SEM rules in advance of East/West commissioning 2012
CPM Medium Term Review	<ul style="list-style-type: none"> • Assessment of CPM in the SEM • Impact of CPM on customers 	September 2010	April 2011	April 2012 – potential modifications

	<ul style="list-style-type: none"> • Incentives for Generators Capacity • Payments when Capacity is needed • Distribution of Capacity Payments • Capacity Requirement Calculation • WACC Methodology • Infra Marginal Rent and CPM • Impact of Exchange Rate in CPM • Treatment of Wind in CPM • Treatment of Interconnectors in CPM • Relationship of CPM with Ancillary Services • Impact of Diversity of Generation and Security of Supply 			
Locational Signals	<ul style="list-style-type: none"> • Locational or postalised TLAFS • Locational or postalised Generation TUOS 	June 2009 (SEM-09-062)	Proposed Decision May 2010	October 2010
Increased Demand Side Participation	Increased DSM participation in SEM - 5 key areas.	January 2010	August 2010	Recommended options from Decision Paper - short/medium/long term initiatives-comprehensive DSM strategy
Ancillary Services	Harmonised AS	June 2009	January 2010	Completed February 2010

2.2 SEM Review Projects

In addition to the ongoing development projects listed above, the SEM Committee at its 2010 Strategy Day decided to initiate reviews of the following SEM areas over the coming year.

Market Power and Liquidity in the SEM

At the Strategy Day, the SEM Committee noted the importance of reviewing and improving liquidity in the wholesale electricity market with an emphasis on fostering increased competition and mitigating barriers to new entry in both the spot and contract markets. As the SEM structure continues to develop and competition increases, the SEM Committee also planned to review the extent of market power in SEM. In the meantime the SEM Committee received a submission from ESB regarding industry changes and progressive deregulation of ESB. The SEM Committee has decided, therefore, to amalgamate examination of the ESB submission and the Market Power and Liquidity reviews into one overall review. This review will include an assessment of current and likely future levels of market power/liquidity in the SEM, the effects of market power mitigation measures, the effects of ESB's reintegration proposal on market power/liquidity and ways in which this might be mitigated as well as looking at other ideas for improving liquidity and/or reducing market power.

There will be full consultation with market participants as the review progresses. It is expected to be completed by the end of the year.

In addition to the above, there was a review of governance arrangements of the Market Monitoring Unit (MMU) conducted by consultants for the RAs in 2009. The review considered issues such as the role of the MMU in monitoring, analysing and making recommendations on bidding behaviour in the SEM. Implementation of recommendations is expected in 2010.

Uplift Review

Given the importance of the uplift component of the energy price in the SEM and its impact on consumer prices and generator revenues, the SEM Committee has decided to review the performance of this aspect of the market to date and measure this against possible alternatives. An alternative to the current uplift mechanism will be considered as part of the review and measured against the SEM Objectives. The review of uplift will likely include the following analyses:

- measure of uplift component of price
- actual start-up and no-load costs
- revenue through uplift and infra-marginal element
- assessment against SMP objectives
- overview of incentive compatibility of SMP algorithm
- modelling an alternative cost recovery method and assessment against SMP objectives.

The review of uplift will commence towards the end of this year with the aim of finalising it in early 2011.

3 Conclusion - Assessment Framework for SEM Committee Medium Term Decisions

Conclusion

This paper has presented the original Objectives of the SEM which the SEMC considered when discussing the proposed changes to the SEM design currently underway and further areas of review in the medium term. The RAs have consulted on a series of individual work-streams to meet development needs. A risk is that the integrity of the SEM design could be compromised due to lack of coordinated policy making by the SEMC and it is therefore necessary to put in place a framework for medium term decision making in the SEM.

The SEM Committee takes the view that while the SEM has development requirements such as the need to facilitate new interconnectors, evidence thus far suggests that the SEM is working well. The costs of fundamental changes in design now - in terms both of system costs and of the effect of increased regulatory risk – may outweigh the potential benefits. In the meantime, the SEM Committee will examine each proposal for design change to ensure that they are consistent with the objectives of the SEM and with the basic design and that they do not have unintended consequences somewhere else in the system, looking at all workstreams holistically.

Clearly, the ideal strategy is to give consistency to investors and existing market players whilst allowing the market to develop and adapt to changing circumstances in line with the SEM Objectives and to the benefit of customers and participants. Furthermore, the longer term strategic development of the SEM should be based on the SEM Objectives and the key external drivers.

To conclude, the SEM Committee feels that the SEM is fit for purpose in meeting its objectives, at least in the medium term. Due to the importance of regulatory consistency any fundamental changes to the market design should be reviewed as set out below:

Recommended Assessment Framework for SEM Committee Decisions

The following shall be used as a paradigm for SEM Committee Decision making when considering policy decisions in the future:

1. SEM Strategic Objectives: Decisions have to be measured against SEM Committee strategic objectives and must further these - such as promotion of competition, interests of consumers, environment etc.

2. Regulatory Consistency: Decisions must be in line with the original principles and design of the SEM and targeted only at cases where action is needed.

3. Cross Issue Impact Assessment: Decisions on changes to SEM design must include an assessment of interactions and impacts of proposed changes across the market and other work stream proposals. All proposals for change to include a regulatory impact statement and a cost-benefit analysis of the proposed change to the existing market design.

Beyond the Medium Term: Projects that do not meet each of these criteria may feed into a Long Term Strategy.

It is judged that to date, and likely in the medium term future, the SEM is working well, that there are known challenges ahead but that for now these can be met whilst continuing to meet the SEM Strategic Objectives and without fundamentally redesigning the SEM.