

# Single Electricity Market Committee

## ***SEM Committee Decision on Implementation of the European Target Model for the Single Electricity Market***

### ***Next Steps Response Paper***

***15 February 2013***

On 24th January 2012, the SEM Committee published a Consultation Paper on Implementing the European Electricity Target Model in SEM. The consultation closed on 20th April and 22 interested parties responded. Subsequently, on 9 November 2012, the SEM Committee published its paper on Next Steps in the Target Model implementation process as a Proposed Decision. Comments were invited from interested Stakeholders on the Proposed Decision and dispatch reports, in particular on the SEM Committee's recommendation to government on High Level Principles for redesign of the SEM to implement the Target Model. A total of 19 responses were received and 18 of these were deemed to be non confidential and are accordingly published with this paper.

The SEM Committee Decision Paper considers further issues raised by respondents to the SEM Committee's Proposed Decision on Next Steps and details where particular comments and SEM Committee responses relate to the consultation paper and where others relate to the Proposed Decision. Views expressed by respondents to the proposed decision have been fully considered by the SEM Committee in reaching its final decision as outlined in this Paper.

For clarity, this response paper summarises SEM Committee views on responses, **the resultant changes made to the Proposed Decision and sets out the next steps in the project.**

#### ***1. Certainty and the European Target Model***

- We welcome respondents support for our proposed decision to maintain the current design of the SEM until 2016. Some respondents queried the status of SEM workstreams and modifications in progress.
- The SEM Committee will continue to consider any modifications recommendation reports that are presented to it and will measure the costs and benefit of any proposal against the TSC and the SEM Committee objectives. If a modification proposal is judged to be a material change, we will expect that it will consider the new market arrangements and interfaces with the Target Model as well as the current SEM rules. The decisions set out in the rest of the paper set out a broad framework for market

integration and as we expect further clarity on the high level design to be developed during phase 2.

- Regarding other regulatory workstreams such as locational signals and demand side participation, we recognise the importance of joined up thinking and a coherent and stable regulatory framework. We agree that locational signals are an important feature of the market design and we will consider whether these need to be reviewed as part of the consideration of zones delimitation in the SEM.

## **2. *Impact Assessment and Cost Benefit Analysis***

- The SEM Committee welcomes the comments made by respondents on this issue and reaffirms its commitment to undertake an impact assessment, including financial and economic analysis, before any key decisions are made
- Good regulatory practice requires that decisions are evidence based and justified against transparent criteria (such as SEM objectives, High Level Design Principles) and subject to a regulatory impact assessment. While we intend to make use of cost benefit analyses during the course of implementing the Target Model, we will not rely solely on these in our decision making.
- In order to best meet our principal duty of protecting the interests of the consumer, we will provide clear reasons for our decision and impact assessments to support these including, where appropriate, cost benefit analysis. We expect that an impact assessment will be carried out before reaching a final decision on any aspect of the new high level design.
- The SEM Committee decision is that **the redesigned SEM shall be subject to an impact statement that is in line with best practice and a cost benefit analysis, where appropriate, that takes into account the key energy policies that are materially affected by the wholesale electricity market.**

## **3. *High Level Principles***

- We welcome the strong support from respondents for our proposed recommendation on High Level Principles for the Market set out in the Proposed Decision. Some respondents pointed to other metrics that should be considered by the SEM Committee such as competitiveness on the island of Ireland, non discrimination between domestic and cross border market players and the contribution of renewable energy sources to meet several of the other principles. Some respondents stressed the importance of striking an appropriate balance and between the high level principles when and applying weighting to them in a holistic manner that is in line with legislative duties. One respondent sought further clarification on the meaning of each principle and the origin of the 'adaptive' principle.

- We consider that there has been adequate discussion of these principles both in the High Level Design documents (AIP/SEM/06/05) and in the SEM Committee Consultation on Implementing the European Target Model (SEM-12-004). On the 'adaptive' principle, this was included as part of the assessment criteria set out in the SEM Proposed High Level Design (see page 39) and, more generally, is in line with best regulatory practice<sup>1</sup>.
- Given this broad support we do not see any reason to revisit these principles for the final decision paper and accordingly make the recommendation on High Level Principles to the Departments as per the Proposed Decision.
- The Departments have indicated that they accept this recommendation from SEM Committee

#### **4. Project Governance**

- We acknowledge the views expressed by respondents on project governance and stakeholder engagement and the importance of these to the success of the project to implement the Target Model.
- We commit to best practice in relation to project management in terms of having an appropriately resourced inclusive well planned inclusive process. We see stakeholder engagement as a two way process and look forward to working with market participants in a constructive manner.
- We commit to clear and transparent communication between all stakeholders involved (RAs, Departments, market participants, consumers groups TSOs) as we move forward towards the 2016 implementation deadline.
- We clarify the governance arrangements to be put in place for the project and the roles of stakeholders including market participants, consumer groups and TSOs.
- Some respondents raised concerns about the influence of SEMO and the TSOs within the process. Given the key role that the TSOs have through the drafting of the Network Codes and the implementation of many aspects of the Target Model (in particular SEMO's role in implementation of the central market systems) a strong working relationship between the RAs and the TSOs and market participants will be essential to ensuring that the project is a success and is delivered on time. Given the continued concerns of a number of stakeholders in this regard, we will keep a watching brief on any perceived conflicts of interest that may arise.

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<sup>1</sup> For more see for example:  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31623/11-795-principles-for-economic-regulation.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31623/11-795-principles-for-economic-regulation.pdf)

- We welcome respondents' observations and constructive proposals on project governance. As for the establishment of a SEM integration stakeholder group or of expert groups, the SEM Committee intends now to follow the same process as was followed in the stage leading up to a decision on the high level design of the SEM, namely:
  - the establishment of a project office;
  - the retention of consultants with the necessary expertise in market design and the European target model;
  - the establishment of a stakeholder forum for the market integration project that communicates project updates to stakeholders and involves market participants and consumer groups in the development of the market design and implementation of the design
  - the formulation of options for a re-designed SEM that would be compliant with the European Target Model in all four timeframes (forwards, day ahead, intraday and real time) and which would meet the objectives set out in SEM-12-105a;
  - consultation on those options for a twelve week period, during which a series of workshops will be held with stakeholders; and
  - publication of a decision on a high level design.
- We are committed to strong stakeholder engagement throughout the next stages of this project and will bear in mind the level of engagement that took place during the development of the SEM together with our experience since 2007 as well as European level mechanisms for stakeholder input into the Target Model. Following publication of this paper we will issue a project initiation document setting out in detail the form and timetable for the overall framework of stakeholder engagement and project management
- In conclusion, the SEM Committee recommend that the following be established:
  - ***A DCENR – DETI Sub Committee of the Joint Steering Group as the forum for interaction between governments and regulators.***
  - ***A UK-Ireland Steering Committee on European Market Integration chaired by DCENR and DETI, with input from DECC as required.***
  - ***A Regulatory Authority Project Office for the implementation of the European Target Model.***
  - ***A Stakeholder Forum on Implementing the Target Model in SEM.***
  - ***Joint Regulatory Arrangements with OFGEM.***

- ***A Stakeholder Forum on the European Internal Market which will be jointly chaired by the RAs and TSOs.***

The departments have accepted the above recommendation and further details on project governance and timetables will be published when the project office is established and consultancy expertise has been secured

## **5. Dispatch Models and Market Design**

- The SEM Committee acknowledges that clarification is required on the terminology used in its decision on central dispatch and that the relationship between this decision and the market design should also be clarified
- Given the confusion around terminology and the important link between the dispatch model and market design, we consider it appropriate to recast the SEM Committee decision in clearer terms.
- In short, we intend to preserve the core of the centralised nature of electricity wholesale trading arrangements on the island of Ireland. We see this as being in line with the Target Model and conducive to the commercial operations of different market players.
- To continue to proceed with an approach where the whole range of market models are on the table may be an easier decision to make at this time, but we are of the view that this would seriously jeopardise the ability of the SEM Committee and the Departments to meet their obligations in implementing the Target Model by 2016.
- Given the planned increase in intermittent generation in both Ireland and Northern Ireland, coupled with the coming of the European internal market and the SEM Committee's primary objective to protect consumers through the promotion of competition, we see no compelling reason to explore further a decentralised physical bilateral contract market
- Some respondents raised the issue importance of market power mitigation and forward hedging as key elements to the revised market arrangements.
- Market power mitigation will remain an important consideration for the redesigned SEM. While we do not propose to design a market around market power measures, it would be unwise to develop the design without the requirement to mitigate market power in mind. The three pillars of market power mitigation in the SEM (the bidding code of practice/market monitor, directed contracts and ring-fencing) will need to be reviewed and developed to take into account the new market arrangements.
- On liquidity, at a high level, we see the European Target Model (in particular the day ahead and forward stages) as important for the development of liquid forward

markets and will ensure that the forward market is a key consideration in developing the high level design.

- Our position is therefore that the market will be based on centralised trading arrangements and will not rely on participants entering into matched physical bilateral contracts and facing financial penalties for failing to do so. This does not mean that options for self commitment or more flexible bidding and scheduling processes are being ruled out (indeed they may be necessary to meet elements of the Target Model) though market power considerations would have to be fully borne in mind when considering these options.

The SEM Committee Decision has been amended to state that there will be a working assumption:

- ***that the SEM high level design will continue to be based on transparent centralised trading arrangements, least-cost dispatch of total system load and centralised unit commitment. It will not rely on a process whereby market participants are required to enter into matched physical bilateral contracts and where there are financial penalties imposed for not doing so.***
- ***Options for self commitment may be permitted within this high level design, taking into account the particular characteristics of the electricity sector on the island of Ireland, including the need to mitigate market power.***
- ***There will continue to be market power mitigation measures in the SEM for as long as market power is considered to be an issue.***

## **6. Renewable Energy Sources**

- We welcome respondents' views on the interactions between the Target Model project and renewable energy sources on the island of Ireland. Given the importance of government renewable energy targets and the broader decarbonisation of the electricity sector, we are committed to ensuring that the wholesale market arrangements on the island of Ireland and their integration with the European internal electricity market are robust to the challenges of facilitating high penetration of renewable energy sources.
- Regarding the wording of the proposed decision, we clarify that the term '*where appropriate*' simply reflects the wording in legislation and refers to the legal powers that the regulatory authorities have in this regard. In restating that this statutory objective will continue to apply in the new market arrangements, we were seeking to assure stakeholders of our commitment to the promotion of renewable energy sources.

- On the issue of the treatment of curtailment in tie break situations, the SEM Committee will publish its decision on the treatment of curtailment in tie break situations shortly. This paper will deal with both the SEM Committee's proposed decision for the treatment of curtailment in dispatch and the eligibility of curtailed wind for DBC payments
- We note that whilst renewable support schemes are the remit of government in both SEM jurisdictions, we agree that a robust market reference price against which feed in tariffs and other support schemes are referenced is important for renewable generation. Ensuring that there is efficient wholesale market design with transparent price formation and a liquid spot market is critical to role of the RAs in the promotion of renewable energy sources.

The SEM Committee decision has been amended to state that in the revised market arrangements to implement the Target Model:

- ***The absolute interpretation of Priority Dispatch will remain as set out in SEM Committee Decision Paper SEM-11-062***
- ***Changes to the SEM High Level Design should, in line with our statutory duties, promote, where appropriate, the use of energy from renewable energy sources, as set out in legislation.***

## **7. Capacity Mechanism**

- We acknowledge respondents' views on capacity mechanisms and agree with the need to ensure a stable regulatory environment for investment by setting out a high level framework for the development of the revised market arrangements.
- The SEM Committee notes the European Commission's consultation on generation adequacy and the points raised about the need to avoid distortions in the internal market. Through their membership of the Council for European Energy Regulators and ACER, the RAs have conveyed their views on the issues raised to the EC and will participate in an ACER working group to assess the impacts of capacity mechanisms on the internal electricity market with a particular focus on any cross border trade implications.
- In summary, the SEM Committee notes that the capacity payment mechanism in the current SEM design has been acknowledged to add significant value and that capacity mechanisms are at various stages of consideration and implementation in a number of European electricity markets.

The SEM Committee Decision remains unchanged from that in the proposed decision paper:

- ***It is important that the total remuneration from energy payments, capacity payments and ancillary services is sufficient to ensure security of supply.***
- ***Any capacity payment mechanism must not provide double payments to generators***
- ***The capacity payments mechanism will need to avoid distortions in the internal market and comply with relevant EU rules***

### **Next Steps**

Following publication of the SEM Committee Decision Paper which the Departments accept, we will:

- Procure expert consultancy support in the areas of market design and project management and resource a project office
- With our consultants, draft and publish a Project Initiation Document (PID) for the next phase of the project. This document will outline the project scope and workstreams, roles and responsibilities (of RAs, TSOs, market participants and other stakeholders), high level and detailed project timelines, reporting and governance arrangements, projects risks and resources.
- Engage with Ofgem and submit to ACER our 'Roadmap to 2016' setting out the key milestones to achieving compliance with the target model. The roadmap will be developed in parallel with the PID referred to above.