

# **I-SEM Roles and Responsibilities**

**Consultation Paper  
SEM-15-016**

**Power NI Response**

17 April 2015

## **Introduction**

Power NI welcomes the opportunity to respond to the SEM Committee's Consultation Paper on the I-SEM Roles and Responsibilities

As the Regulatory Authorities (RAs) are aware, Power NI is the largest electricity retailer in Northern Ireland. Power NI is part of the Viridian Group which has within its portfolio a retail position in Northern Ireland and the Republic of Ireland, as well as a significant thermal and renewable generation presence.

Power NI is however a separate business. Power NI's legal, managerial and operational separation is mandated via licence condition and it is within the context of being a supplier without vertical integration; that Power NI has approached the I-SEM design process.

## **General Comments**

Prior to responding to the specific questions posed, Power NI has a number of general comments in relation to the area of roles and responsibilities.

During the 'Building Blocks' discussions, it became clear that the roles and responsibilities within the I-SEM design were crucial to the clarity of a number of the topics. Roles such as Central Counter Party, Clearing House, Single Point of Registration, NEMO and Shipper were all described. Likewise within the 'Markets' discussion the role of SEMO in particular in relation to the nature of the relationship with the pricing coupling algorithm requires clarity.

The proposed design also relies heavily on the EUPHEMIA algorithm. To aid the design the RAs should resolve the questions of PCR membership, roles, responsibilities and governance as a matter of urgency. Power NI welcomes the RAs acknowledgment and progress in this regard.

The consultation has identified the key roles and principle considerations of conflicts of interest and synergies. While potential synergies are explored in more detail under the specific questions; at a high level, it is difficult to imagine, in a relatively small market such as the I-SEM, how appointing a single body to multiple roles on a price controlled basis, would not bring implementation and operational efficiencies.

In appointing organisations to roles within I-SEM, adequate governance is crucial. It is not however an insurmountable issue. The RAs have a number of regulatory options including, primarily, licence conditions to ensure adequate business separation; as well as operational and managerial independence.

As stated above, Power NI believes that there are synergies available by having a single entity fulfilling multiple roles. This must however be accompanied by appropriate ring fencing and governance provisions.

Conflicts of interest are most apparent when commercial incentives are in play. The current arrangements have the TSO in the role of system operator, market operator and asset (EWIC) owner. The I-SEM considerations could potentially widen the roles to DS3 auction operator, Capacity Administrator and Aggregator.

While synergies of operation are important, the RAs have correctly identified the issue of EWIC owner as a direct conflict. The TSO would in effect be hosting an auction (for both capacity and ancillary services) which they could also be competing in or have a commercial interest in the design and outcomes from. They would also be operating a market in which they would be actively competing against other entities who are not the system or market operator. Power NI believes the conflict of EWIC ownership is an important area for the RAs to actively consider across a number of workstreams and not limited to one.

General operational governance of the designated body or bodies is an important concern. While the RAs may appoint the NEMO and seek to mandate business separation it will also be important to create a market structure sufficient to ensure that the views of I-SEM participants are appropriately represented at the European fora. Power NI understands that the I-SEM represents a single market integrating with a large number of significantly bigger markets. Adequate representation will be vital and the RAs should ensure that appropriate market structures and incentives are in place so that the NEMO is mandated to act in the best interests of the Irish market and Irish consumers.

Power NI is also concerned that the RAs are seeking to designate a NEMO in isolation. Synergies and cost efficiencies are undoubtedly available by having a single counter party fulfilling roles in excess of the NEMO function.

In completing the designation process as described, the RAs risk an entity responding who, while qualified to be the NEMO, do not necessarily wish or are unable to fulfil the other roles such as BMO, capacity settlement etc. It is unclear therefore should this circumstance arise if the RAs would have any other option other than to designate the applicant as a NEMO. By attempting to complete the NEMO designation in isolation therefore, the RAs risk not being in a position to avail of the full range of synergies available.

## Specific Questions

### **Do you agree that the TSOs should carry out the role of delivery body for the capacity mechanism?**

In terms of practical implementation and providing regulatory oversight; it would appear prudent to appoint the TSO to the role of delivery body. The RAs however should be cognisant of the potential conflict of interest which stems from being both the auction host and an auction participant (as EWIC owner). Appropriate business separation must be a pre-requisite in this regard.

It will also be important to establish a clear governance framework surrounding this role. Questions of design, particularly the detailed nuances which have a significant effect, must be the responsibility of the RAs and not the TSOs in the role of delivery agent.

### **Are there [any?] synergies and economies of scope from having a single entity perform the I-SEM market operator roles, i.e. day ahead and intra day, imbalance settlement and capacity settlement? If so, how would these lower costs to consumers?**

Power NI believes there will be clear economies of scale and cost efficiencies available to the market by having a single entity performing multiple roles.

In the first instance the cost and burden of registration can be streamlined by having a single registration entity. Multiple entities would require participants to register multiple times, provide details and pay fees. This creates an administrative burden which would be particularly onerous on smaller participants. It also acts as a barrier to entry for new participants.

Dependent upon each entity's systems and procedures, participants may also require separate internal IT systems to efficiently communicate. This mandates additional establishment cost, on-going participation costs and adds risk.

Multiple market operator counterparties will also require participants to incur additional collateral and working capital costs. These costs would be incurred as each operator will calculate required credit cover in the market they are administering in isolation using the maximum exposure. A participant therefore who trades in different markets will have to post credit equal to their maximum in each market rather than a holistic view of their total requirement.

For example, should there be a different party fulfilling the role of market operator for the Day Ahead and Intra Day Markets, if a participant on one day bought 80%

of their volume Day Ahead and due to pricing on another day bought 80% Intra-Day, it would be conceivable that the Day Ahead Market Operator would mandate collateral posted to the highest value, 80%, and the Intra Day Market Operator would require the same, 80%. The participant therefore, even though they have bought the same volume on each day, would in effect have to post collateral equating to 160% of their required volume.

This example also equally applies should an entity's other than the NEMO (or NEMOs) be settling the balancing market. That entity will also seek to have collateral posted to the maximum historic exposure. Continuing the example above therefore, a Supplier on the third day could end up buying 80% from the Balancing Market. The BMO would therefore require collateral which equates to at least that exposure. All three entities therefore would require the Supplier to have posted separately with them, collateral which equates to 80% of its volume. This is clearly a cost which would be passed to consumers and could easily be avoided.

To a large extent the current market suffers from the same phenomenon, by differentiating the collateral required in the forwards market from the collateral required in the spot market, a participant in effect posts collateral twice for hedged volumes. Power NI would urge the RAs to, wherever possible, look to minimise such costs. Collateral costs are, in today's market, a significant burden on suppliers.

The SEM also facilitates the reduction in working capital costs through the use of 'Settlement Reallocations'. Power NI strongly believes an equivalent should be made possible in the I-SEM design. It is however difficult to envisage that being possible if multiple market operator entities are present.

The RAs have also stated a minded to position that capacity settlement could be carried out by the entity responsible for imbalance settlement. Power NI concurs with this view. There will be clear operational efficiencies from an entity using the metered load volumes for two purposes. Utilising more than one entity would require multiple interfaces for participants and should queries be raised it would reduce the administrative burden and general complexity by having to only raise the query with one body.

**Do you think there are conflicts of interest arising from the same entity performing the market operator and TSO roles in the I-SEM? If so how would these increase costs to consumers and what mitigation measure could be put in place to deal with these?**

As noted above there are clear conflicts of interest both in the current SEM and within the design of the I-SEM. The RAs have correctly identified the ownership of EWIC as a direct conflict with the core TSO role, Capacity Mechanism

Administrator, DS3 Administrator and Market Operator. Power NI is disappointed that the RAs appear to prefer to deal with this under a different workstream. This issue cuts across a number of areas including designation of the NEMO.

It is also as important for the RAs to deal with the perception of conflict as with any conflict itself. Investors must have confidence in the I-SEM if they are to either enter or continue to invest. Clear, robust regulatory decisions and market structures are the only mechanism to deliver such confidence.

**Do you have any views on the RAs interpretation of the NEMO designation criteria?**

The RAs interpretation of the NEMO designation criteria appears appropriate. Power NI is concerned however as to how the RAs intend to implement appropriate governance so that participants can be assured that one of the designated NEMOs is representing the views of the Irish market effectively at a European level.

Power NI recognises that the I-SEM NEMO will be one voice amongst a number of European NEMOs and that compromise and negotiation will be required. As the RAs are aware the I-SEM will be a small and complex market which may require special provisions. The designated NEMO must appropriately represent the views of the I-SEM participants however Power NI is unclear as to how the RAs intend to ensure that that is the case.

**Do you have any views on the RAs proposed NEMO designation process?**

The management of the designation process is a difficult task for the RAs. It has similarities to a traditional procurement exercise in that it must be open and transparent, however it would appear that the RAs may have to appoint multiple NEMOs should sufficient parties meet the criteria. This would appear at odds with the general desire to realise the synergies available by appointing one NEMO.

The areas of conflicts of interest and governance, as described above also require careful consideration.

In addition, Power NI is concerned that the RAs are seeking to designate a NEMO in isolation. As stated above, synergies are available by having a single counter party fulfilling roles in excess of the NEMO function. By undertaking a process of NEMO designation separate to the appointment of an entity to undertake all the identified roles, the RAs risk an entity responding who, while qualified to be the NEMO would become designated even though they do not necessarily wish or are able to fulfil the other roles such as BMO, capacity settlement etc. By attempting to complete the NEMO designation in isolation therefore, the RAs risk not being in a position to secure the full range of synergies available.