



Information Note on I-SEM Regulatory Framework

SEM-16-007

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1.1 BACKGROUND

The European Union (EU) is building an internal market for electricity and gas to help deliver energy supplies that are affordable, secure and sustainable. This is underpinned by the implementation of the European Electricity Target Model (EU Target Model) arising from the EU's Third Energy Package. Specifically, the EU Target Model is a set of harmonised arrangements for the cross-border trading of wholesale energy and balancing services across Member States. In this context, the SEM Committee committed to implementing the Integrated Single Electricity Market (I-SEM) which is due to go-live in Q4 2017, updating and (in some respects) replacing the current Single Electricity Market (SEM) arrangements.

The European Commission Regulation (EU) 2015/1222 of 24 July 2015, *establishing a guideline on Capacity Allocation and Congestion Management (CACM)* came into force on 14 August 2015. Article 83 of CACM imposes obligations on Northern Ireland and Ireland in the period from CACM's entry into force until December 2017 to implement preparatory transitional arrangements leading to full implementation and full compliance by 2017. Both DETI and DCENR have consulted on their proposals with respect to amending national legislation to facilitate the updating of the SEM arrangements. Following extensive consultation during 2014, the SEM Committee published the Decision Paper on the High Level Design (HLD) for the I-SEM. The scope of the HLD is in accordance with the SEMC's statutory objectives. Namely, it seeks to maximise benefits for consumers in the short and long-term, while ensuring security of supply and meeting environmental requirements. Subsequently, the Detailed Design Phase of the I-SEM commenced and a number of workstreams were established including the Energy Trading Arrangements (ETA) workstream and the Capacity Remuneration Mechanism (CRM) workstream. Decision Papers published to date include:

- High Level Design Decision (SEM-14-085a), 17 September 2014;
- ETA Detailed Design Markets Decision Paper (SEM-15-065), 11 September 2015;
- ETA Building Blocks Decision Paper (SEM-15-064), 11 September 2015;
- Aggregator of Last Resort Decision Paper (SEM-15-063), 11 September 2015;
- NEMO designation decision papers (SEM-15-073 and SEM-15-073b), 2 October 2015;
- Assignment of TSO obligations under Article 1.3 of CACM (SEM-15-079a and SEM-15-079b), 7 October 2015;
- I-SEM Roles and Responsibilities Decision Paper (SEM-15-077), 7 October 2015;
- FTR Decision Paper (SEM-15-100), 15 December 2015; and
- CRM Detailed Design Decision Paper 1 (SEM-15-103), 16 December 2015.

With respect to the content of the above listed published decisions, it is not envisaged that additional decision documents will be issued by SEM Committee to implement the I-SEM market design (unless otherwise specified). Rather, the relevant decisions will be reflected in the proposed modifications to licences, amendments to and introduction of market rules (such as the Trading and Settlement Code, Capacity Remuneration Mechanism market rules and subsidiary documents) as developed by the I-SEM Rules Working Groups or other forums on foot of the RA decisions. The SEM

Committee will, following appropriate consultation, determine whether such detailed rules will be approved and implemented.

1.2 PURPOSE OF THIS PAPER

On 7 October 2015, the SEM Committee published an Information Paper entitled 'Market Rules Information Note and Invitation for Nominations to Participate in Market Rules Working Group' (SEM-15-078). The paper described the working group approach to the development of rules and legal drafting for the I-SEM and sought nominations from interested parties for individuals to participate in the working group process. The paper committed to clarifying the overarching regulatory framework of the new market as well as providing detail on the consultation process. Since the October Information Paper was published, thinking within the RAs has developed. In addition to the development and implementation of the Trading & Settlement Code (essentially encompassing the rules for the energy trading arrangements for the market), separate Capacity Remuneration Mechanism (CRM) Rules and NEMO Rules will be developed.

The purpose of this paper is therefore:

- to provide clarity on the overarching regulatory framework, comprising legislation, licence changes and market rules which will implement the market design referred to as I-SEM;
- to provide insight on the provisional timeline and proposed consultation process regarding licence changes and the introduction of revised (and new) market rules; and
- to provide initial thinking on NEMO regulation and enforcement.

REGULATORY FRAMEWORK

The Single Electricity Market (SEM) for the island of Ireland went live on 1 November 2007 and consists of a centralised and mandatory all-island wholesale pool through which generators and suppliers trade electricity. The current SEM arrangements are provided for in (i) legislation (the Single Electricity Market Act 2007 in Ireland and the Single Electricity Market (NI) Order 2007 in Northern Ireland), (ii) licences for generators, suppliers, Transmission System Operators (TSOs), Market Operators (MOs) and Interconnectors in Ireland and Northern Ireland; and (iii) a suite of contractual arrangements (set out primarily in the Trading and Settlement Code, Bidding Codes of Practice, Grid Codes and Metering Codes).

The Regulatory Framework for I-SEM will comprise changes to legislation and licence obligations (on Transmission Systems Operators, Market Operators, Generators and Suppliers) in both jurisdictions. The market rules (e.g. the Trading and Settlement Code) for I-SEM will also undergo change from the existing rules. Consideration of the changes required is currently taking place under the umbrella of the Market Rules Working Groups.

We set out below a summary of the changes to the various components of the regulatory framework that may be made in order to implement I-SEM.

2.1 LEGISLATION

Legislative changes will be made to facilitate the implementation of I-SEM. These changes will reflect the fact that the SEM operates within the framework of the European Union rules on cross border trade for electricity. A consultation on proposed legislative changes has been conducted by both, the Department of Enterprise, Trade and Investment (DETI)¹ and the Department of Communications, Energy and Natural Resources (DCENR).

The legislative changes are expected to be in place in both jurisdictions later this year. In Ireland, the Energy Bill 2016 (Number 11 of 2016) was published on 20 January 2016. This Bill contains an amendment to the definition of the Single Electricity Market (as currently set out in the Electricity Regulation Act 1999) to make specific reference to the European cross border rules. DETI has committed to having regulations in place to provide legislative clarity for Northern Ireland.

¹ <https://www.detini.gov.uk/sites/default/files/consultations/deti/electricity-single-wholesale-market-northern-ireland-order-2007.pdf>

2.2 LICENCES

A number of licence changes will be required which may include but are not limited to the issues outlined in the table below. It should also be noted that the table does not reflect perspective licence modifications where no SEM Committee Decision on the policy has yet been made. The below table is provided solely as a guideline for market participants as to possible licence changes and the planned timeframe when the consultations on licence modifications are expected to commence.

A detailed mapping exercise is being carried out by the Regulatory Authorities to identify and finalise the legal drafting of required licence changes. The terms of any proposed licence modifications will be subject to the usual statutory consultation process (as set out in Article 14 of the Electricity (Northern Ireland) Order 1992 and section 20 of the Electricity Regulation Act 1999). The RAs plan to implement the licence modifications in two tranches, with consultation on the first set taking place in April 2016 (pertaining largely to Market Operator and Transmission System Operator licence changes) and consultation on the second tranche in Q3 or Q4 2016 (pertaining largely to generator and supplier licences but also incorporating licence changes for the MO and TSO licences which will not be developed until after the April consultation).

Indicative Table of Potential Licence Changes and Approximate Timeframes

| Licence Type | New/Amendment | Indicative Change | Consultation Timeframe |
|-------------------------------|---------------|--|------------------------|
| SONI and EirGrid TSO Licences | New | Requirement for the provision and maintenance of a Balancing Market Principles statement. | September 2016 |
| | New | Requirement to enter into and to maintain a Capacity Market Code (CMC). The CMC is to be developed by the TSOs subject to the direction and approval by the RAs. | April 2016 |
| | New | The Capacity Allocation and Congestion Management (CACM) role of Shipping Agent under which it will be responsible for transferring net positions between central counter parties. | September 2016 |
| | Amendment | Addressing the issue of Prohibited Activities as outlined in SONI and EirGrid licences to accommodate the NEMO role and aggregator of last resort. This licence condition differs across jurisdictions and therefore licence change may or may not be required or the matter may be dealt with by way of regulatory consent. | April 2016 |

| Licence Type | New/Amendment | Indicative Change | Consultation Timeframe |
|------------------------------|---------------|--|------------------------|
| | Amendment | Amendment of Grid Code provisions contained in licences as required. | April 2016 |
| | Amendment | Amendment of Central Dispatch licence condition as required. | April 2016 |
| | Amendment | SEM Transitional Provisions, many of which have expired but will need to be replaced with equivalent provisions for I-SEM. | April 2016 |
| SONI and EirGrid MO Licences | New | Depending on the RAs implementation of the governance arrangements for NEMOs operating in I-SEM, the Designated Nominated Electricity Market Operator (NEMO) role. | September 2016 |
| | Amendment | In line with legislative changes in Ireland and Northern Ireland, an amendment to the Trading and Settlement Code licence condition to provide for the adoption of the amended TSC (which is to be drafted by the Rules Working Group and subject to the approval of the RAs). | September 2016 |
| Generator Licences | New | A new licence condition requiring accession to the Capacity Market Framework Agreement and compliance with the CMC. | September 2016 |
| | New | A new licence condition requiring generators to be balance responsible. | September 2016 |
| | New | A new licence condition requiring that all Day Ahead and Intra-Day energy trading is executed through a designated NEMO and to comply with the NEMO rules. | September 2016 |
| | New | Review of existing conditions and possible development of transitional provisions | September 2016 |
| Supplier Licences | New | A new licence condition requiring that all Day Ahead and Intra-Day energy trading is executed through a designated | September 2016 |

| Licence Type | New/Amendment | Indicative Change | Consultation Timeframe |
|--------------|---------------|--|------------------------|
| | | NEMO and to comply with the NEMO rules | |
| | New | A new licence condition requiring suppliers to be balance responsible. | September 2016 |
| | New | Review of existing conditions and possible development of transitional provisions. | September 2016 |

2.3 GRID CODE

Any requisite changes to the Grid Codes will be effected through the established Grid Code revision/modification processes. These changes will be implemented following the legislative changes (as set out above), licence changes to the TSOs' licence regarding the Grid Code and Central Dispatch) and any other necessary changes arising from discussions at the Rules Working Group.

2.4 TRADING AND SETTLEMENT CODE

As set out above, the Market Rules Working Group will develop recommended detailed drafting of the updated TSC. It is envisaged that the amended TSC will be comprised of two substantive parts:

- Part A: this will contain all of the provisions of the existing Trading and Settlement Code (including glossary and appendices) and will be retained for a run off period of at least 13 months; and
- Part B: this will contain all of the enduring provisions relating to I-SEM arrangements.

Each part A and B will have the capability of existing in isolation from and without reference to the other. An additional subsection may be required to deal with the transition between the SEM arrangements and I-SEM arrangements.

The updated Trading and Settlement Code comprising substantive parts A and B will come into effect at a date to be directed by the RAs (and in respect of a particular trading period). This Trading and Settlement Code will be implemented in Ireland via a Statutory Instrument and a change to the EirGrid Market Operator Licence (condition 3) and in Northern Ireland by virtue of a change to the SONI Market Operator licence (condition 15) in Northern Ireland.

2.5 FRAMEWORK AGREEMENT

The SEM Framework Agreement ('the Agreement') is an Agreement between EirGrid plc and SONI Limited in their joint capacity as Market Operator for the purpose of the Trading and Settlement Code and Framework Members where the Framework Members agree to be bound by the Agreement and the terms of the Trading and Settlement Code. As such, this Agreement is a core element of the market regulatory framework. As the existing Trading and Settlement Code Framework Agreement makes a number of references to 'the Pool' arrangement, it is envisaged that this Agreement will be amended and re-executed by Framework Members. The RAs are currently considering how this might be most effectively achieved and will notify market participants through the I-SEM Plan when we expect revisions to the Framework Agreement to be made and signed by Parties to the TSC.

2.6 CAPACITY MARKET CODE

The legal drafting for the Capacity Market Code (CMC) will take place by the TSOs under the direction of the RAs. A consultation will take place on the full text of the market rules as developed prior to approval by SEM Committee.

The CMC, like the TSC, will be implemented as a multilateral contract to which parties would accede via a Framework Agreement and which will oblige such parties contractually to comply with the Code provisions. This approach will give potential investors in future generation confidence in the stability of the arrangements over the period of their Capacity Market Agreements.

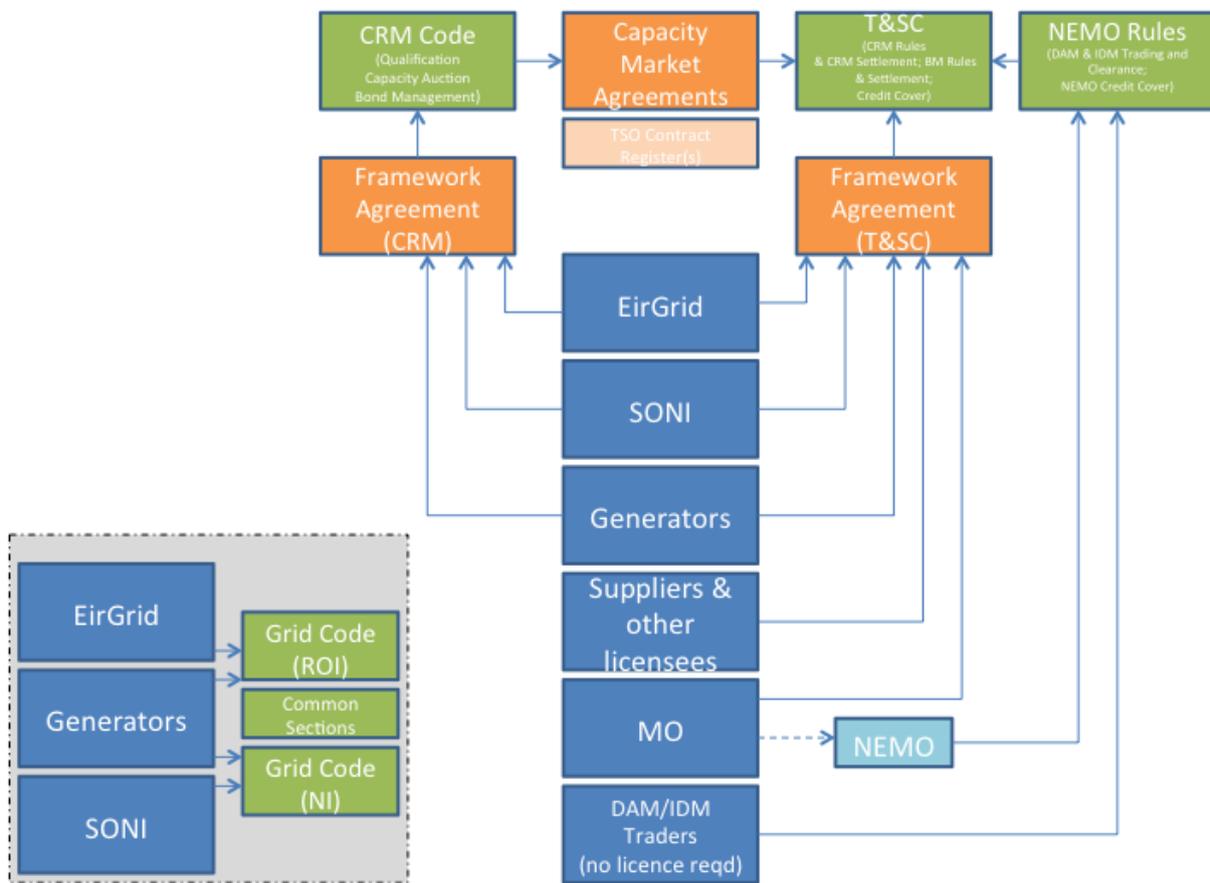
There will be a close relationship and interactions between the new Capacity Market Code (CMC) and the Trading and Settlement Code (TSC).

The CMC will specify the process by which generators and demand side units can qualify to take part in the capacity auction and gain a Capacity Market Agreement. The TSC will give effect to CRM settlement in accordance with rules set out in the Trading and Settlement Code. The TSC will specify that the Market Operator (SEMO) must be provided with all the data in the Capacity Market Agreements so that the payments can be calculated based upon the rules in Part B of the updated TSC.

This arrangement is shown in the diagram below (Figure 1), where all Electricity Licence holders are required to be Parties to the TSC, but neither suppliers (other than through their role as DSUs) nor the Market Operator are expected to be Parties to the CMC.

This approach will also allow the TSC to specify credit cover requirements for both energy trading and CRM together. Credit cover for trading through the NEMOs is likely to have to be separate.

Figure 1: I-SEM Regulatory Framework²



In this diagram the codes are shown in green, the licensees in blue and the agreements in orange. The diagram shows that both the Capacity Market Code (CMC) and the Trading and Settlement Code (T&SC) are multi-lateral contracts each subject to a Framework Agreement to which Parties must accede. The CMC is connected to the T&SC through the Capacity Market Agreements, which are the result of the capacity market qualification and auction processes and which contain the detailed information which allows the T&SC to undertake settlement of the payments and charges in respect of those agreements.

All licensees and any non-licensee who wishes to trade in the Balancing Market must be Parties to the T&SC (together with SONI and EirGrid as Market Operators) but only generators (including DSUs) are Parties to the CMC (together with EirGrid and SONI as TSOs).

The NEMO rules also feed into the T&SC to provide the data needed for Settlement in the Balancing Market which depends upon Day Ahead and Intra-Day trades, which also determine the Physical Notifications in the Balancing Market. Only those who wish to trade in the Day Ahead or Intra-Day Markets will have to comply with the NEMO rules and it is expected that settlement in these

² It should be noted that this diagram is intended for illustrative purposes only. It is not intended that the diagram is a definitive guide to the operations of I-SEM across all timeframes; nor is it intended that the diagram be an accurate depiction of every single entity which will operate in I-SEM. Rather, the diagram provides a high-level pictorial representation of the I-SEM Regulatory Framework.

markets will be the subject of a bilateral contract for each such participant. Both generators and suppliers will be required to trade in the DAM and IDM only through the designated NEMO in their jurisdiction. SONI and EirGrid have been designated as NEMO in the relevant jurisdiction.

The Grid Code arrangements are shown separately, where both EirGrid and SONI have separate Grid Codes which apply in their jurisdiction but the Grid Codes have common sections which are the same in both jurisdictions.

2.7 CONSULTATION

Extensive consultation with industry on the market rules relating to energy trading arrangements and the settlement of the Capacity Remuneration Mechanism is currently taking place through the established Market Rules Working Group.

In addition to this extensive consultation and engagement with industry that will take place as part of the five-stage Market Rules Working Group process, a final consultation will take place on the full text of the Trading and Settlement Code, with a planned date of Q4 2016.

The head of terms for the Capacity Market Code (covering the CRM Auction, Qualification and related issues) will be set out as part of CRM Decision Paper 3 and developed thereafter into legal drafting by the TSOs for submission to the RAs for approval. In addition, an extensive consultation on the full text of the Capacity Market Code will take place in Q4 2016.

2.8 NEMO GOVERNANCE AND ENFORCEMENT

The European Commission Regulation on Capacity Allocation and Congestion management (CACM Regulation) came into force on 14 August 2015. It sets out provisions for coupling of the day-ahead and intra-day electricity markets across the European Union. To achieve market coupling, the CACM Regulation requires the creation of harmonised trading arrangements across the interconnectors which link the transmission system in different Member States. To develop, implement and operate the systems required for market coupling, the CACM Regulation requires that Member States designate one or more entities as a Nominated Electricity Market Operator (NEMO).

On 2 October 2015, EirGrid plc was designated as a NEMO for Ireland and SONI Ltd was designated as a NEMO for Northern Ireland under Article 4 of the CACM Regulation. NEMOs will play an important role in the development of terms and conditions and methodologies required to achieve market coupling. The Regulation prescribes NEMO cooperation with TSOs for certain aspects and cooperation with other NEMOs to agree these methodologies.

Once terms and conditions and methodologies have been agreed and implemented, NEMOs are responsible for the on-going operation of a number of market coupling functions including:

maintaining and operating the algorithms, systems and procedures needed for day-ahead and intra-day market and validating and disseminating the results of trading.

The CACM Regulation sets out procedures for the revoking of the designation of non-compliant NEMOs. This would be an action of last resort. The CACM Regulation provides that designation could be revoked if compliance is not restored within six months of notification of non-compliance. Where a NEMO, designated in another Member State, fails to comply/ maintain compliance with the designation criteria, the national regulatory authority can suspend the right to offer day-ahead and intra-day trading in its territory, where that NEMO is unable to restore compliance within three months of notification on on-compliance.

Under Article 6 of the CACM Regulation the CER and UR will continue to ensure the compliance of EirGrid plc and SONI Ltd with the designation criteria set out in the Regulation. In particular an annual compliance check will be carried out on an ongoing basis relying on publicly available data, informal engagement with NEMOs, stakeholders and wider regulatory bodies at a regional and European level.

In addition, discussions are ongoing at a European level as to how NEMOs should be governed more generally.

Given that from I-SEM Go-live, only one NEMO has been designated for Ireland and for Northern Ireland thus far, and given the importance of the NEMO markets to the I-SEM, the RAs are considering what degree of additional regulatory oversight may be appropriate in order to ensure that NEMO costs are efficient and the interests of consumers are protected. The CER and UR are considering what NEMO monitoring tools and/or enforcement powers might be appropriate. It should be noted that the issue of NEMO regulation and CACM compliance is a matter of concern to European Regulators including Ofgem who, for example, with the Department of Energy and Climate Change are currently consulting on NEMO regulation and enforcement with respect to the NEMO designation in Great Britain³.

2.9 NEMO RULES

The SEM Committee considers that given that NEMO rules (i.e. the pricing and settlement arrangements for the Day Ahead and Intra Day timeframe) are commercial arrangements between a NEMO service providers and participants in the Day Ahead and Intraday timeframes, it is appropriate that NEMO rules be housed within a NEMO market rules that should exist outside of the Trading and Settlement Code.

Notwithstanding this, any designated NEMOs offering trading services in the I-SEM will need to interface with the wider I-SEM arrangements and the RAs will give further consideration as to what governance and contractual arrangements may be required to support this.

³<http://www2.nationalgrid.com/UK/Industry-information/Electricity-codes/European-network-code/Decision-letters/>

2.10 BALANCING PRINCIPLES DOCUMENT

The RAs are (together with the TSOs) considering the content of a Balancing Market Principles Statement, the obligations relating to which would be enforceable by licence.

3 CONCLUSIONS AND NEXT STEPS

The RAs look forward to further interaction with industry on the substantive texts of the T&SC and CMC through consultation in Q4 2016. Workshops may be held in advance of consultations, where appropriate.

Consultations on proposed licenced changes will take place in April 2016 and September 2016. In this Information Paper, the RAs have provided an indicative table as an initial guideline for market participants as to potential licence changes and their likely timeframe.

The RAs will re-establish a European Stakeholder Forum as a mechanism to update industry on network code developments at ACER and ENTSO-E as well as affording representative groups the opportunity to present on or engage on issues relevant to network code developments.