



SINGLE ELECTRICITY MARKET COMMITTEE

System Services

Future Arrangements

Consultation Report & Decision Paper 1

SEM-21-021

30 March 2021

1 EXECUTIVE SUMMARY

The System Services Future Arrangements project was formally launched by the SEM Committee in July 2020 with the publication of a Scoping Paper for comment. A period of stakeholder engagement followed this, through the consultation window, which closed on 3 October 2020, and is still ongoing. The purpose of this publication is to provide an update to stakeholders following review of the responses to the Scoping Paper and consideration of the subsequent further engagement with stakeholders.

The SEM Committee received 24 responses to the Scoping Paper, and has had significant engagement with stakeholders since then on request. At this point, the SEM Committee considers the Scoping Phase of the project to be concluded, and this paper formally closes this phase out and moves into the next, high level design phase. It is anticipated that this phase will take place over the remainder of 2021, and following on from this the project will move into the implementation phase, which will be led by the TSOs. The SEM Committee expects there to be consultation on more detailed design aspects during the implementation phase.

This paper also summarises the consultation responses, and provides a SEM Committee response to comments on some of the questions. Of the 17 questions asked in the Scoping Paper, the SEM Committee addresses points made on the European Requirements and Governmental Plans (Question 1), the Objective and Assessment Criteria (Question 3), the general approach (Question 4) and the Fixed Contract Arrangements (Question 15). The remainder of the topics will be addressed in a more detailed consultation to be launched in Q2 2021.

Finally, the paper makes a number of decisions directly related to the topics answered in the consultation response section. The SEM Committee has determined that the final objective and assessment criteria will remain unchanged with the addition of three new criteria, Enabling the Energy Transition, Clarity for Investors and Transparency. The SEM Committee has also decided on a three-stage project approach, consisting of the Scoping Phase, High Level Design Phase and Implementation Phase.

The SEM Committee has decided to grant a 12 month extension to the current Regulated Arrangement contracts, meaning these will now end on 30 April 2024. While the SEM Committee acknowledges the benefit in taking as much time as possible in developing the framework, it is also cognisant of the need to move quickly on this, in the context of the energy transition.

The paper also sets out a framework for further Fixed Contract Procurement. This framework will be used when required to encourage the development of new technology projects. Reference is also made to exploring the use of this project for low carbon sources of inertia in the short term.

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2 INTRODUCTION & BACKGROUND

The purpose of this paper is to set out a number of decisions made by the SEM Committee in relation to the Future Arrangements for System Services beyond the current Regulated Arrangements, which are set to expire on 30 April 2023. It also provides an update on the current plan for further consultation and a decision on the high level framework for these Future Arrangements.

On 8 July 2020 the SEM Committee published a Scoping Paper on the Future Arrangements for System Services. This paper was open for public consultation for a period of 12 weeks. It set out at a high level the SEM Committee's initial thinking on the System Services arrangements that will apply following the conclusion of the Regulated Arrangement contracts and invited views from stakeholders. During the 12 week period workshops were held where presentations were made by the Regulatory Authorities (RAs), the TSOs, the DSOs and industry representatives.

The consultation period ended on 2 October 2020, and 24 responses were received. In the intervening period the RAs have held several bilateral engagements with the TSOs, DSOs and industry members and have reviewed the responses. Based on the Scoping Paper responses and the engagement with stakeholders, the SEM Committee considers that the optimum approach would be to set out a number of decisions in this paper and hold a more detailed consultation on the outstanding topics later in 2021.

In summary the SEM Committee has made decisions in the following areas:

- Objective and Assessment Criteria;
- European Requirements;
- Government Plans;
- Extension of Regulated Arrangements; and
- Fixed Contract Arrangements.

The subsequent consultation will cover the auction design and governance arrangements in detail. Additional considerations such as market power will be covered through additional consultations following a decision on the high level design of the Future Arrangements, expected by the end of 2021.

2.1 Document Structure

Sections 1 and 2 set out the Executive Summary of the paper and Introduction and Background for the project. There is a summary of the work done to date and what is being set out in the paper.

Section 2 summarises the responses to the Scoping Paper which was open for comment in 2020. Comments from the SEM Committee are also included.

Section 3 details a number of decisions made by the SEM Committee following consideration of the points raised under the Scoping Paper, while Section 4 provides the next steps for the project.

3 SUMMARY OF SCOPING PAPER RESPONSES

The SEM Committee received 24 responses to its Scoping Paper. Responses were received from the TSOs collectively, each DSO on the island, a number of representative bodies of different technology types, direct industry participants and wider stakeholders. Two responses were marked as confidential, while the remaining 22 were published on the SEM Committee’s website on 12 November 2020. Responses were received from the following:

| | | | |
|-----------------|------------|--------------|----------------|
| ABO Wind | Aughinish | Bord Gais | Bord na Móna |
| DRAI | EAI | Eaton | EirGrid & SONI |
| ESI | ESB GT | ESBN | Energia |
| Fingleton White | GridBeyond | IWEA & NIRIG | Moyle |
| NIEN | PHG | RES | RWE |
| ScottishPower | TEL | | |

A wide range of views were provided on each topic, and the SEM Committee has summarised these below. Overall respondents welcomed the level of engagement and the move towards developing arrangements beyond 2023. The majority urged caution in developing a new framework too quickly, which is set against the TSOs’ viewpoint that urgency is needed in order to have a set of arrangements in place by May 2023 which will deliver the mix of services required to achieve 2030 renewables and decarbonisation targets.

It is worth noting that two respondents simply wrote in to note their support for the Energy Storage Ireland (ESI) response, while another response was the same as that of the Demand Response Aggregators of Ireland (DRAI).

For clarity, there were 17 questions asked in the Scoping Paper, of these questions 1, 3, 4 and 15 will be addressed in this paper, while the remaining questions will be addressed in the second, more detailed High Level Design Consultation Paper. However, the SEM Committee has summarised the responses for all questions asked in the Scoping Paper in this section.

3.1 European Requirements and Governmental Plans – Scoping Paper Q.1

The Scoping Paper set out a number of Articles under the Electricity Balancing Guidelines (EBGL) and the Clean Energy Package (CEP) which the SEM Committee considers to be important in the context of developing the future arrangements. Question 1 of the paper asked if there were any additional views on the European Requirements and Government Plans.

Of the 24 respondents, 17 provided views on this question. Two respondents considered that a comprehensive list of requirements was provided, while the remaining responses either provided additional consideration or raised issue with what was included.

In relation to government targets, seven respondents mentioned Northern Ireland's Energy Strategy as being important once developed and published, and made reference to the recent comments by the Minister for the Economy in relation to having similar 2030 targets to Ireland. Six respondents also noted the Climate Act Amendment Bill in Ireland, which will introduce a 7% annual carbon reduction target. One respondent argued that the arrangements should be driven by decarbonisation policy.

In terms of European compliance, some additional requirements were mentioned by respondents. Three highlighted that the System Operation Guidelines (SOGL) had not been mentioned, and two indicated the non-discrimination requirements under the CEP. One respondent noted that the requirement for standard products would need to be explored further. Both TSOs and DSOs noted the requirements for TSO/DSO coordination under the EBGL and SOGL.

The TSOs also made reference to EU Directive 2014/25/EU¹ in relation to their contracting obligations, which is important in the context of developing fixed contract procurement, and also referenced obligations relating to the procurement and management of ancillary services under EBGL, which is important in the context of governance arrangements. The DSOs provided detail on requirements and obligations that are placed on them.

Six respondents highlighted the unique challenges faced on the SEM System in terms of non-synchronous penetration and being isolated from the central European system, and gave the view that the European requirements should not be viewed as a one size fits all approach. Additionally, four respondents stated that due to Brexit the island system is no longer directly interconnected with another EU Member State, there may be more flexibility in terms of complying with the European Requirements until the Celtic Interconnector is completed.

3.1.1 SEMC Comments

The SEM Committee notes the comments made in terms of the Governmental Plans and European Compliance. It is apparent that, as one respondent noted, areas of policy and regulation are constantly evolving, so the assessment criterion of adaptability will be of significant importance in ensuring that a framework is developed which can adapt to future changes in policy.

¹ Procurement by entities operating in the water, energy, transport and postal services sectors

The SEM Committee acknowledges that policy in both jurisdictions will directly influence the energy transition. The Future Arrangements will have regard to this transition and will be adaptable to the associated change this will bring about to the portfolio of energy providers in the SEM.

In terms of the European Requirements, the SEM Committee notes all additional requirements and regulations cited by respondents and will take these under consideration. While the Scoping Paper did acknowledge that the island does have unique circumstances, the SEM Committee considers that the European Requirements provide good foundations to build the framework and then adapt it to suit the SEM's unique challenges. In terms of the comments related to Brexit and interconnection, this would require putting in place a short term, rather than an enduring, framework. Whilst the SEM is not currently connected to any other EU Member State, the SEM Committee wants to ensure that the arrangements put in place are consistent with European regulations insofar as possible at this point in time. The SEM Committee does not see value in designing a set of arrangements that would need to be redesigned to comply with European Requirements when the Celtic Interconnector connects, if this can be avoided. The SEM Committee does not consider this approach to be consistent with the criteria set out in Section 4.1.

More detail of decisions in relation to the European Requirements and Government Plans is included in Section 4.3 of this paper.

3.2 DSO Role – Scoping Paper Q.2

Within the European Requirements, the Scoping Paper pointed to Articles which reference the role of the DSO in the operation of ancillary services markets and called this out as an important consideration when developing the Future Arrangements. Specifically, stakeholders were asked to provide their views on the DSO role in response to question 2 of the Scoping Paper.

Of 24 respondents, 21 provided a response to question 2. All 21 respondents consider there to be a vital role for the DSO in the Future Arrangements, with 14 respondents highlighting the importance of the DSO having an active role in the development of the arrangements. Four respondents particularly expressed the view that TSO/DSO coordination is highly important.

Three respondents consider it important that the DSOs are given adequate funding to unlock value through improvement of the network.

The DSOs stated their view that they need to be heavily involved in the design and development of the arrangements to ensure that these work for distribution connected providers. They stated their view that the regulated arrangements were designed in a manner which only considers transmission connected providers, but as we move towards a decentralised system it is vital that the framework is designed with the distribution networks in mind. This includes having direct influence on governance and the interface between all distribution connected providers and the

TSOs. Both DSOs provided detailed proposals on how to maximise participation of distributed connected providers, which can be found in their responses under SEM-20-074.

Both DSOs noted that their understanding of this work is that it pertains only to the TSO procured System Services, and would not cover services designed by the DSOs specifically for the distribution networks.

3.2.1 SEMC Comments

The SEM Committee notes the high level of support for significant DSO involvement in the development and operation of the future arrangements. The DSO will have a vital role to play in coordinating with the TSO to ensure that the participation of distribution connected providers is fully facilitated as the system becomes more decentralised in the coming years.

The proposals set out by the DSOs will be taken under consideration in the high level design of the Future Arrangements, and the DSO will play an important role in engaging and assisting in developing these arrangements.

3.3 Objective and Assessment Criteria – Scoping Paper Q.3

The Scoping Paper sought views on an objective and set of assessment criteria for the project.

Question 3 of the Scoping Paper sought views on the objective and assessment criteria. 19 of the respondents commented on this.

In terms of the objective, the majority of respondents did not propose any amendment to the objective with the objective as set out in the Scoping Paper. However, three respondents indicated a preference to include some form of time limitation to the framework, tying the future arrangements to delivering on renewables and decarbonisation targets for 2030.

In terms of the Assessment Criteria, the majority of respondents included suggestions for additional criteria to consider. Two respondents suggested that transparency would be an important criterion to include, while four respondents echoed points made by respondents to question 1 on the European Requirement with a request for the inclusion of a non-discrimination criterion.

11 respondents argued that a criterion for investment certainty should be included, to give confidence to developers, while seven respondents suggested the inclusion of an environmental, renewable or decarbonisation associated criterion.

Additional criterion suggested include safety and transitional arrangements, while the TSOs made a number of suggestions including liquidity, market power, suitability for investment, ease of access, transition costs and transaction costs.

3.3.1 SEMC Comments

The SEM Committee notes comments made by stakeholders. In terms of the objective, the SEM Committee acknowledges the comments regarding the inclusion of reference to any future 2030 targets². The SEM Committee also acknowledges a wider theme around policy and decarbonisation targets. However, it should be noted that the immediate objective of this workstream is to introduce competitive arrangements for the procurement of the System Services products where possible. That being said the SEM Committee will be cognisant of ensuring that the competitive arrangements will be able to also support, in so far as is possible, government policy. Taking this into consideration, the intention is to put in place a framework that could underpin future 2030 targets, with scope for adaption to new developments as necessary.

Moreover, in relation to decarbonisation, the SEM Committee sees System Services in and of themselves as a tool to help maintain system security and facilitate increased renewable penetration. This is reflected in the objective to facilitate increased SNSP levels, and this will be a vital support to the energy transition.

In terms of investor certainty, the SEM Committee considers that while the arrangements should provide some level of clarity and accessibility to providers so they can make informed decisions, these will be competitive arrangements for which a return on investment cannot be assured. A well designed market should provide an appropriate pricing signal for the requisite services. For this reason Investor Certainty is not considered to be an appropriate criterion, though there is merit in considering Clarity as a criterion, with the aim to provide early and clear pricing signals through a predictable market design process to inform investment decisions.

Of the remaining proposals, non-discrimination is a European requirement and therefore covered under that criterion, while Transparency stands out as potentially adding value to the arrangements and has been taken under consideration by the SEM Committee.

Further details on the SEM Committee's decision in this area can be found in Section 3.

3.4 General Approach – Scoping Paper Q.4

The Scoping Paper set out a general approach to the project which included an interpretation of what existing products would be categorised as balancing capacity by reference to the standard EBGL products, and it also indicated a preference to proceed with developing and implementing the framework by May 2023. Question 4 of the paper sought views on the general approach.

² At present there is no 2030 target in Northern Ireland. However, the Department for Economy is currently working on a future energy strategy, which is expected to consider 2030 targets.

21 of the 24 respondents provided comments on question 4. The majority of respondents were primarily concerned with the timelines for implementation, with 11 of these suggesting that rushing to have a framework in place by May 2023 would result in sub-optimal outcomes. The remaining two respondents noted that work would be required to commence immediately in order to meet the timelines. In addition to these points, the TSOs consider it vital that every effort is made to deliver the arrangements as soon as possible, as the Regulated Arrangements are not suited to supporting the delivery of the required generation portfolio for 2030. One respondent noted the National Grid's incremental roll out of ancillary services through the 'System Needs and Products Strategy'.

One respondent considered there to be sufficient time for auctions to be in place by May 2023, but that a transparent volumes analysis by the TSOs would be required to confirm this. Two respondents also highlighted the need to publish timelines by Q1 2021 to provide clarity to stakeholders.

Four respondents indicated a need for a review of the existing products with a view to introducing additional products that may be of benefit, with three respondents referencing downward balancing capacity, and associated European requirements under the CEP for this, and another highlighting the demand turn up service seen in GB.

3.4.1 SEMC Comments

The SEM Committee acknowledges the stakeholders' responses. In terms of the delivery timelines, the SEM Committee has included a decision for an extension in Section 3 of this paper, which it considers to be a balanced compromise between timely delivery, and giving early and clear signals to developers in relation to the arrangements.

Additionally, the SEM Committee sees value in some stakeholder suggestions in relation to clarity around the volumes, these informing the market design, along with a review of the System Services products. The SEM Committee will continue to engage with the TSOs in relation to these points.

3.5 Categorisation of products – Scoping Paper Q.5, 6 & 10

21 of 24 respondents issued a response to questions 5 and 6. Upon review Question 10, which was in the Market Design section covers very similar ground, and so has been grouped with Questions 5 and 6. 13 respondents indicated that at a minimum the reserve or frequency based products would be suitable for daily auctions, with one respondent stating that this change can only happen under a holistic approach where other products, such as reactive power, are moved to a complementary procurement framework.

Three of those respondents added the Ramping Margin products and FFR to the list that should be categorised under this approach, while three respondents supported moving any system wide

products to daily auctions. One respondent supported a phased approach with moving all products that a volumes analysis reveals sufficient competition for to auctions as early as possible, while transitioning the remaining products as competition increases.

Five respondents indicated that further analysis is required to understand levels of competition in the markets, with two indicating that there would not appear to be sufficient competition at this time. One respondent indicated a preference to wait for sufficient competition among low carbon sources.

Three respondents indicated significant concerns that daily auctions would not provide sufficient investment signals, and highlighted the need for longer term procurement. A further two respondents also noted a preference for long term procurement, including annual auctions.

Six respondents indicated that localised products such as reactive power would need bespoke arrangements.

3.5.1 SEMC Comments

The SEM Committee notes the comments of stakeholders, and will take them into consideration in the High Level Design. This area will be covered in more detail in the consultation paper to be published in Q2.

3.6 Governance Arrangements

Views were also sought on what governance arrangements should apply to the Future Arrangements, including the qualification process. Stakeholders were asked under Question 7 for their views on the qualification process through the procurement gates and the QTP, and under Question 8 if the existing framework would be fit for purpose or if new arrangements would need to be developed. Question 9 then asked how the arrangements should be funded.

3.6.1 Qualification Process – Scoping Paper Q.7

21 of 24 respondents commented on this question. 18 responses were in favour of some form of greater flexibility to the qualification process. Four respondents consider that the current gate tendering process is sufficient for the Regulated Arrangements however a more streamlined process would be more effective under market based arrangements, with increased flexibility around qualification times. Suggestions included an accreditation process which would allow providers to qualify without the need for six monthly windows, and a continuous on boarding process similar to market registration. Four respondents took issue with the current process as being too restrictive and onerous on developers, while six did not directly comment on the current process but were in favour of increased flexibility under the Future Arrangements. Three respondents made reference to potentially extending the testing windows as a workable solution. One respondent, while indicating that the current process is adequate for the regulated

arrangements, noted that there are significant issues in terms of the timelines being unduly long, particularly for DSUs.

Seven respondents were supportive of the Qualification Trial Process, with none raising any issues.

The TSOs consider the current process to be readily transferable though did note that improvements can be made, while the DSOs commented that there will need to be improvements in terms of distribution connected parties.

3.6.1.1 SEMC Comments

The SEM Committee acknowledges the comments of stakeholders. This area will be covered in more detail in the consultation paper to be published in Q2.

3.6.2 Governance Arrangements – Scoping Paper Q.8

21 of 24 respondents commented on this question. 12 respondents were in favour of simplifying the arrangements and moving to a single document. Counter to this, one respondent urged caution in simplification as it may give the TSOs too much unilateral power by moving everything under the umbrella of the Protocol Document. Additionally, 10 respondents believe that there should be increased industry involvement in modifications to such a document, with 8 in support of a an approach similar to having a Mods Committee.

Two respondents, including the TSOs, highlighted the legal responsibilities and requirements under European requirements for the TSOs to be in charge of procurement of System Services, and pointed out that divesting the decision making in terms of governance may interfere with the TSOs ability to carry out its duties.

The DSOs highlighted the need to ensure that distribution connected parties are well represented during the development of any governance arrangements.

3.6.2.1 SEMC Comments

The SEM Committee acknowledges the comments of stakeholders and considers that a forum for the TSOs to consult with industry will be an important element for the arrangements. This area will be covered in more detail in the consultation paper to be published in Q2. The requirements in relation to the TSOs functions are noted, and any review of the governance arrangements will ultimately be cognisant of the TSOs responsibilities in this area.

3.6.3 Funding Arrangements – Scoping Paper Q.9

18 of the 24 respondents provided comments to the SEM Committee's question on how System Services should be funded. Of these, six responses indicated that an approach similar to how

Imperfections are recovered should be considered, essentially this would keep forecasting responsibility and volatility risk with the TSOs, but move the funds into an independent pot away from the network tariffs. Six respondents consider the network tariffs to be the most appropriate place for recovery, with some noting that suppliers are less well positioned to forecast annual System Services costs than the TSOs, leading to potential volatility in retail prices. One of these responses noted that the societal benefit of System Services should be quantified and a portion covered by general taxation, as a measure of decarbonisation.

Three respondents considered there to be merit in a supplier based approach, but one cautioned that there will need to be measures in place to ensure the TSOs continue to be incentivised to forecast accurately and maintain downward pressure on prices. Echoing this another respondent noted the need to continue some form of incentivisation on forecasting, without giving a direct preference for an approach.

The TSOs welcomed acknowledgement of funding complexities and look forward to working with the RAs to develop arrangements which minimise financial exposure of TSOs. Similarly, ESNB noted that care should be given in minimising price volatility for system and market operators.

3.6.3.1 SEMC Comments

The SEM Committee acknowledges the comments of stakeholders. This area will be covered in more detail in the consultation paper to be published in Q2.

3.7 Market Design

The Scoping Paper looked to explore potential design options for the auctions. These were covered under Questions 11 to 14 of the paper.

In their consultation response the TSOs provided a range of auction design options which encapsulated all the questions on market design. These options included sequential options pre DAM, sequential options post DAM, an option to co-optimize energy and System Services, a hybrid option for flexible constrained ex-ante auctions and parallel auctions based on the constrained ex-post position. These proposals will be taken under consideration when developing the consultation paper in Q2.

3.7.1 Timing of Auctions – Scoping Paper Q.11

16 of the 24 respondents commented on this question. While it was generally observed that further exploration is required in this area, six respondents indicated that consideration of holding auctions after DAM results are published may be of the most benefit, with one noting that this may not suit all technology types, while four respondents support the co-optimisation of energy and system services or holding auctions as close to real time as possible.

Four respondents indicated a preference for some sort of hybrid approach to timings either based on technology type or on the relationship between service provision and energy actions. Of the remaining two responses, one considered day ahead auctions to be preferable, while the other did not support daily auctions, with a preference for long term procurement.

All other respondents noted that further exploration is required through more detailed consultation, and were not in a position to comment at this time.

3.7.1.1 SEMC Comments

The SEM Committee acknowledges the comments of stakeholders. This area will be covered in more detail in the consultation paper to be published in Q2.

3.7.2 Commitment Obligations – Scoping Paper Q.12

12 of 24 respondents commented on Commitment Obligations, with the remainder considering there to be too little detail at this time. Three respondents noted that the commitment obligations need to be more proportionate when compared to the existing obligations which can be quite punitive. Two respondents noted that any arrangements need to be cognisant of grid code obligations, and should not punish providers if moved away from contracted position due to TSO actions related to grid code obligations. A further two responses highlighted that providers should not be punished for actions outside of their control.

Other points included that there should be a presumption of adherence unless there is clear evidence to the contrary, and a proposal that penalties could include a proportionate financial penalty for the first infringement and a requirement to requalify for repeated infringements.

3.7.2.1 SEMC Comments

The SEM Committee acknowledges the comments of stakeholders. This area will be covered in more detail in the consultation paper to be published in Q2.

3.7.3 Market Interactions – Scoping Paper Q.13

10 respondents provided views on market interactions, between System Service products and between the other markets. The majority of respondents, eight, were concerned with ensuring that a full holistic view of the System Services, energy and capacity markets is considered when developing the Future Arrangements. In particular these respondents noted that a review would need to be carried out of the other markets when developing the Future Arrangements, to ensure there is no risk of adverse revenue impacts.

Two respondents noted that conventional plant are currently encouraged to incorporate their System Services tariff revenues into their energy and capacity bids as an opportunity cost, and this clouds the true consumer value of the System Services. They consider that services should

be treated as an independent revenue stream over and above the fair cost of energy, and this will need to be reflected in the market design. One respondent also highlighted concerns with the impact of ongoing uncertainty on System Services income when bidding into T-4 capacity auctions.

Separately one respondent, commenting on interactions between the Services themselves, proposed that reserve services should be bundled together in auctions as it would be inefficient for example, if one provider was successful in a POR auction but unsuccessful in the corresponding SOR and TOR1 auctions, as these services can be effectively provided together. Conversely, a further comment related to the need to ensure that providers retained the right to choose which services they could bid on.

3.7.3.1 SEMC Comments

The SEM Committee acknowledges the comments of stakeholders. This area will be covered in more detail in the consultation paper to be published in Q2.

3.7.4 Additional Market Design Considerations – Scoping Paper Q.14

In terms of additional design considerations, the majority of respondents felt there was insufficient information to comment at this time. One respondent highlighted the need to consider smaller distribution connected parties, while further responses reiterated points made under previous questions such as requesting a detailed timeline by Q1 2021, highlighting potential issues around Grid Code obligations and commitment obligations and co-optimising the System Service with energy.

Additionally, ESB GT set out a number of further considerations including sequencing, service grouping, service interaction, temporal granularity, locational requirements and realisability. Further details on these points can be found on the response publication page, SEM-20-074.

3.7.4.1 SEMC Comments

The SEM Committee acknowledges the comments of stakeholders. This area will be covered in more detail in the consultation paper to be published in Q2.

3.8 Fixed Contract Arrangements – Scoping Paper Q.15

The SEM Committee also sought views on the Fixed Contract Arrangements under Question 15 of the Scoping Paper. 20 of 24 respondents commented on this, with all respondents supporting some form of fixed contract procurement to take place if required. Eight respondents noted that these should be used to incentivise the development of new technologies, with a further two commenting that they could be used generally to incentivise new developments.

Four respondents noted that they could be effective in supporting the transition from regulated arrangements to the future arrangements, while a further two noted that they should only be used if there is insufficient short term competition. Additionally, one respondent consider that these should be prioritised over short term auctions.

Two respondents provided indicated there being a benefit in using these for to incentivise the development of zero carbon inertia projects. This follows the successful Pathfinder project for tendering of inertia providers carried out by National Grid ESO.

3.8.1 SEMC Comments

The SEM Committee welcomes the support for the Fixed Contract Arrangements. Having considered the responses to the consultation, the SEM Committee considers benefit in using these arrangements to incentivise the development of projects from new technology sources. Further details on the SEM Committee's decision on the introduction of a fixed contract framework is included in Section 3. Consideration will also be given to the comments related to low carbon inertia, and the RAs will continue to engage with the TSOs to explore this further.

3.9 Additional Considerations – Scoping Paper Q.16

Views were sought on what additional considerations there should be when developing the Future Arrangements, with the Scoping Paper highlighting market power as a particularly important item. Question 16 sought views on the additional considerations listed in the paper - market power, investor certainty and smoothing the transition to Future Arrangements, along with any further additional considerations to be included.

13 responses were received to this question, with four responses reiterating the need for an extension of the regulated arrangements to allow sufficient time to develop the future arrangements. Conversely, one response reiterated previous comments on the benefits of moving to auctions by May 2023, along with further comments on the need for a transparent volumes analysis. A further response reiterated the island's unique circumstances and not to use the European requirements as a one size fits all approach.

Further comments related to the maximising of existing grid infrastructure, that data centres can play an important role, and that the rigidity of capacity market bids needs to be looked at if the arrangement changes have an effect on revenues related to auctions which have already occurred. NIEN highlighted that congestion management at distribution level should not be considered within the scope of this project, nor should distribution flexibility services.

3.9.1 SEMC Comments

The SEM Committee acknowledges the comments of stakeholders. This area will be covered in more detail in the future. Comments around the extension of regulated arrangements are

addressed in Section 3 of this paper. For clarity, this project is concerned solely with developing Future Arrangements for Transmission System Services, and distribution specific products will be treated separately.

3.9.2 Market Power – Scoping Paper Q.17

Question 17 of the Scoping Paper was directly related to Market Power considerations. 12 responses were received, with a wide range of views on the topic. Three respondents considered the best approach to be putting in place the market design then addressing market power issues as they become apparent, ex-post. Four respondents raised some concerns with the level of information available, and indicated that greater transparency may help in market power issues.

Other proposals included the introduction of price caps, minimising barriers to entry, avoidance of product bundling and using long term auctions.

3.9.2.1 SEMC Comments

The SEM Committee acknowledges the comments of stakeholders. This area will be covered in more detail in future papers.

4 SEM COMMITTEE DECISIONS

Having considered the responses to the Scoping Paper, along with further engagement with stakeholders, the SEM Committee has come to the following decisions.

4.1 Objective and Assessment Criteria

Further to the points raised under Section 2.2 above, the SEM Committee has decided to include the following additional assessment criteria:

Enable the Energy Transition: The arrangements will be cognisant of policy decisions in Ireland, Northern Ireland and the UK, and will enable the energy transition in so far as possible.

Clarity for Investors: The arrangements will be clear in terms of how auctions will operate, in order to give a reasonable degree of clarity to developers in terms of financing.

Transparency: The framework will be transparent such that there will be no imbalance of information among market participants, and full sight of auction results and procurement requirements will be fully visible.

For completeness, the objective and assessment criteria are set out below:

The objective of the project is:

- to deliver a competitive framework for the procurement of System Services, that ensures secure operation of the electricity system with higher levels of non-synchronous generation.

In order to better facilitate the achievement of this objective, the SEM Committee has developed a set of criteria for assessing the proposed framework:

1. **Consumer Value:** The pricing of services will be market-based in so far as these secure competitive outcomes in order to deliver consumer value, while taking into account levels of market power for each service;
2. **European Compliance:** The arrangements will comply with relevant legislation including the Clean Energy Package (CEP) and the Electricity Balancing Guideline (EBGL) Network Code;
3. **System Need:** The framework will operate in a manner which ensures the needs of the system including security of supply are maintained;

4. **Alignment:** The SEM Committee will seek to ensure appropriate alignment between the markets in energy, capacity and System Services, along with all other relevant revenue streams, to ensure an efficient overall outcome for consumers;
5. **Accuracy:** The volume of services procured should match the requirements of the system as accurately as possible;
6. **Adaptability:** The framework should be sufficiently agile to meet any system changes caused by future policy developments; and
7. **Simplicity:** The framework should be sufficiently simple and transparent to be readily understood and accessible to all stakeholders.
8. **Enable the Energy Transition:** The arrangements will be cognisant of policy decisions in Ireland, Northern Ireland and the UK, and will enable the energy transition in so far as possible.
9. **Clarity for Investors:** The arrangements will be clear in terms of how auctions will operate, in order to give a reasonable degree of clarity to developers in terms of financing.
10. **Transparency:** The framework will be transparent such that there will be no imbalance of information among market participants, and full sight of auction results and procurement requirements will be fully visible.

4.2 Project Approach

4.2.1 Project Plan

The roadmap for the delivery of the Future Arrangements is split into three phases:

- Scoping Phase;
- High Level Design Phase; and
- Implementation Phase.

4.2.1.1 Scoping Phase

The purpose of this phase was to scope out what was needed through the Scoping Paper and stakeholder engagement which has taken place over the past 8 months. The SEM Committee considers the scoping of the project to now be complete. Based on the representations and responses from stakeholders, the project is now in a position to move to the High Level Design Paper, which is commenced through this paper.

4.2.1.2 High Level Design Phase

The High Level Design Phase will take place over 2021. Including this paper, the SEM Committee envisages that there will be three papers published, along with significant stakeholders engagement over the course of the year. This first paper sets out a number of decisions, along with this roadmap to delivery.

The second paper will be a detailed consultation focused on the market design and governance arrangements. The SEM Committee is aiming to publish this in the summer of 2021.

The third paper will be the decision on the high-level design, which will set out the market design and governance arrangements to apply to the Future Arrangements. The SEM Committee is aiming to publish this in Q4.

4.2.1.3 Implementation Phase

The Implementation Phase will commence following the High Level Design. This phase of the project will be led by the TSOs and will run from the High Level Design Decision through to Go-Live of the new arrangements.

4.2.2 Stakeholder Engagement

The SEM Committee will continue to engage with stakeholders through the following approaches.

4.2.2.1 TSO Engagement

The RAs will continue to work closely with the TSOs in developing the Future Arrangements, through regular meetings and sharing of work.

4.2.2.2 DSO Engagement

The RAs will put in place a structure engagement schedule for discussions with DSO, and tripartite engagements with both the TSOs and DSOs, as the High Level Design Consultation Paper is being developed.

4.2.2.3 Industry Engagement

The RAs will continue to be open to bilateral engagements upon the request of industry stakeholders. Similar to the Scoping Paper workshops will be scheduled following publication of the High Level Design Consultation Paper.

4.3 European Requirements

Based on the responses and additional engagement, the SEM Committee has decided to proceed with applying all Articles previously set out in the Scoping Paper in developing the Future Arrangements. This includes the interpretation of the products which are to be categorised as balancing capacity under the EBGL. Though this does not confirm anything in relation to categorisation of products for the purposes of auction design at this time.

With regard to balancing capacity, based on some of the auction design proposals put forward, the SEM Committee is concerned that there is a lack of clarity on the distinction between balancing energy and balancing capacity. For clarity, balancing capacity is a flexible capacity product upon which procurement is based on forecast requirements and has been agreed to be kept available for a certain period in order to provide balancing energy. Balancing Energy is the actual energy used by system operators to maintain frequency.

The SEM Committee considers it important that this distinction is made apparent in the Market Ruleset, to ensure that appropriate price signals are being seen by providers and informing their decisions ahead of FPN and requests the TSO to make proposals in this regard.

The SEM Committee acknowledges the TSOs comments in relation to its responsibilities to procure System Services. The governance arrangements consulted on in Q2 will reflect these responsibilities.

As mentioned in Section 2.1., the areas related to policy are constantly evolving, highlighted by developments that have occurred in the period since the Scoping Paper publication. The assessment criterion of adaptability will be important in this context.

4.4 Extension of Regulated Arrangements

The SEM Committee has decided to extend the Regulated Arrangements, and associated contracts, for a period of 12 months, to 30 April 2024. While the SEM Committee is cognisant of the need for early clarity in relation to the end date of the Regulated Arrangement contracts, based on RA engagements with the TSOs it is apparent that there is a need for timely delivery of this project. The SEM Committee is therefore making this decision which compromises between the TSOs view that a six month extension should be granted, and the wider views of industry that a longer extension would be more beneficial.

4.5 Fixed Contract Arrangements

The SEM Committee has decided to implement a Fixed Contract Arrangement framework from the date of this decision. The intention of this framework is to incentivise entry of new technologies by providing a fixed contract term and a degree of revenue certainty, while enabling provision of services from the most cost-effective technologies able to meet the availability

requirements. Such arrangements were previously used in 2018, where 110MW of Storage technology was procured for a six year period (SEM-18-049). This exercise was successful not only in securing 110MW of System Services contracts at a competitive price, but it also sent strong investment signals to developers of storage project which in turn led to an increase in their development.

It is envisaged that future Fixed Contract Arrangements would follow a similar process to that previously set out through the storage procurement. Accordingly the SEM Committee has decided on the following process. The TSOs will assess the need for targeted procurement of services annually, more frequently if the TSOs consider it necessary. In carrying out this assessment the TSOs shall take the following into consideration:

- The technical scarcities on the system;
- The current volume of services, and the sources of that volume;
- Any localised system needs; and
- Any other issues the TSOs consider relevant to the assessment

The TSOs will submit this assessment to the SEM Committee along with a high-level recommendation whether or not to initiate a Fixed Contract procurement process. The SEM Committee will review this submission and may issue a Direction to the TSOs to prepare a detailed proposal for this procurement process.

The TSOs' will publish the detailed proposal for public consultation which should cover the following:

- The proposed start and end dates of the contract;
- The details relating to the Performance Bond;
- Detailed technical definitions of the services;
- The minimum and maximum volume to be procured in the auction;
- The treatment and application of scalars; and
- Any other proposals that the TSOs consider appropriate.

Following this public consultation the TSOs shall submit a Recommendation Paper to the SEM Committee. The SEM Committee, following a review of the consultation responses and TSOs Recommendations Paper, will then publish a Decision paper setting out the arrangements for that Fixed Contract procurement. The requirements in relation to this procurement will be confirmed in the SEM Committee's Decision on each process. However, it is envisaged that the

auction format and requirements on providers would be consistent with SEM-18-049. Once a decision has been made on the terms, the TSOs will progress with procurement.

One such area in the near term which the SEM Committee considers there to be potential merit for the TSOs to explore is in relation to zero carbon sources of inertia. National Grid ESO have had success in this area with the Pathfinder project, and there have been a number of representations from stakeholders which highlight the potential benefit of carrying out a fixed contract procurement in this area in the near future. The SEM Committee is therefore requesting that the TSOs carry out an assessment on this, and bringing forward proposals for same, should this be required.

4. NEXT STEPS

The SEM Committee is currently developing a detailed consultation paper on the market design and governance for the Future Arrangements. The aim is to publish this consultation by July 2021. The SEM Committee will then hold further engagement sessions with stakeholders, including workshops. Following on from this, the SEM Committee is aiming to publish a decision on the high level design of the Future Arrangements by the end of 2021.

Implementation will commence following publication of the high-level design, with further consultations on additional considerations to be held during that phase. Should stakeholders have any queries or comments please contact Dylan Ashe (dashe@cru.ie) or Owen Kearns (owen.kearns@uregni.gov.uk)