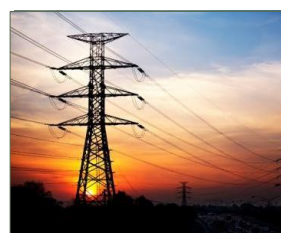


Decision on modifications to NI electricity generation and NI electricity supply Licences, necessitated to implement the Integrated Single Electricity Market (I-SEM)

15 September 2017



About the Utility Regulator

The Utility Regulator is the independent non-ministerial government department responsible for regulating Northern Ireland's electricity, gas, water and sewerage industries, to promote the short and long-term interests of consumers.

We are not a policy-making department of government, but we make sure that the energy and water utility industries in Northern Ireland are regulated and developed within ministerial policy as set out in our statutory duties.

We are governed by a Board of Directors and are accountable to the Northern Ireland Assembly through financial and annual reporting obligations.

We are based at Queens House in the centre of Belfast. The Chief Executive leads a management team of directors representing each of the key functional areas in the organisation: Corporate Affairs; Electricity; Gas; Retail and Social; and Water. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.

Our Mission

Value and sustainability in energy and water.

Our Vision

We will make a difference for consumers by listening, innovating and leading.

Our Values

Be a best practice regulator: transparent, consistent, proportional, accountable, and targeted.

Be a united team.

Be collaborative and co-operative.

Be professional.

Listen and explain.

Make a difference.

Act with integrity.

Abstract

The Utility Regulator commenced a review of all electricity licences in Northern Ireland in April 2016 to implementation of I-SEM. The first in a series of changes were made to the SONI Transmission System Operator (TSO) and Market Operator (MO) licences - these were published on 1 July 2016 and 10 March 2017.

A statutory consultation was then published on 2 June 2017 regarding modifications to the electricity generation and supply licences in NI; a similar process was conducted by the CER simultaneously in Ireland. Key licence modifications proposed in the consultation related to a new Balancing Market Principles Code of Practice (BMPCOP) condition and a new Capacity Market Code (CMC) condition.

In response to representations made by six respondents to the statutory consultation, we have made changes to some of the licence modifications identified in the consultation. The purpose of these changes is to address some of the concerns raised by respondents in their representations (including subsequent engagement) and amend typographical errors. The UR is of the view that the terms of the final licence modifications do not amount to a substantive change from the terms of the proposed modifications (as outlined in the statutory notice published on 2 June 2017).

Audience

This document is most likely to be of interest to the holders of generation licences and supply including DSU licences. A number of regulatory agreements are in place in Northern Ireland between the Utility Regulator and Aggregated Generator Units (AGUs), however, they are not subject to modification at this stage.

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1 Foreword

BACKGROUND

The Integrated Single Electricity Market (I-SEM) is due to go-live on 23 May 2018 and will more fully facilitate coupling with the electricity markets in the rest of Europe. The Utility Regulator (UR) in Northern Ireland and the Commission for Energy Regulation (CER) in Ireland, referred to as the Regulatory Authorities (RAs), have been working alongside EirGrid plc and SONI Ltd to develop the I-SEM, under the governance of the SEM Committee (SEMC).

The SEMC has published policy papers on key issues related to the implementation of I-SEM, including:

- I-SEM Roles and Responsibilities
- Energy Trading Arrangements
- Capacity Remuneration Mechanism
- Market Power
- Financial Transmission Rights

SEM Committee papers relevant to these areas, together with other I-SEM related papers, can be found on the SEM Committee website <https://www.semcommittee.com/>. Information on the UR's role and relevant legislation can be found on the UR's website at www.niaur.gov.uk.

The implementation of SEM Committee policy decisions is effected via modifications to various licences (including Supply and Generation licences), new or amended market rules (including the Trading and Settlement Code, the NEMO Exchange Rules and the Capacity Market Code) and other means overseen by the RAs and reflected in new compliance requirements.

In order to implement the required licence modifications, a dedicated licensing team was established within the RAs in 2015. The licensing team commenced the licence modifications process in 2016 and, to date, two sets of licence modifications for TSO and MO licences have been completed. A third tranche of proposed modifications to Generation and Supply licences was commenced in June 2017. The UR (and CER) conducted the statutory process of licence modifications in line with legislation specific to their jurisdiction.

PURPOSE OF PAPER

This decision paper outlines the UR decisions on the modifications required for the implementation of I-SEM to the following licences: NI electricity 'standard' generation licences, supply licences (including DSU), 'DSU' generation licences, Power NI (PPB) supply licence and AES Ballylumford generation licence.

The final modifications are reflected in the track-changes version of each of the above licence (categories) published alongside this Decision Paper as Annexes 1-5.

The decisions follow a statutory consultation¹ which was published on 2 June 2017². The statutory consultation can be used as a reference for more background detail on developments in the SEM and the statutory licence modification process being followed by the UR.

HIGH LEVEL SUMMARY OF PROPOSED LICENCE MODIFICATIONS

Key licence modifications which were proposed in the NI licences (although not an exhaustive list) included:

- a new condition obliging generators and suppliers (insofar as applicable to them) to comply with the Capacity Market Code (CMC); and
- a modification to the current 'Cost Reflective Bidding in the SEM' condition to "switch it off" when a new 'Balancing Market Principles Code of Practice' condition (BMPCOP) takes effect in each of the licences.

In addition, some minor modifications were proposed to relevant definitions within both the supplier and generator licences to give proper legal effect to the new and modified conditions for implementation of I-SEM.

DOCUMENT STRUCTURE

This document is structured as follows:

- Chapter 1 (Foreword) outlines the purpose and structure of the document;
- Chapter 2 (NI electricity generator licence modifications) outlines the UR's decisions on modifications to existing conditions in the generation licences (including AES Ballylumford and DSU generation licences);
- Chapter 3 (NI supply licence modifications) outlines the UR's decisions on modifications to existing conditions in the Power NI/PPB supply licence

¹ In addition to the statutory consultation, bilateral discussions were held with interested parties (after publication of an open invitation) in March 2017 to provide an initial indication of what modifications were likely to be made to the licences. Some draft legal drafting was provided, including a draft version of a new 'NEMO' condition; from the time of engagement to publication of the licence mod consultation, it was decided not to proceed with a new 'NEMO' condition.

² <https://www.uregni.gov.uk/consultations/proposed-modifications-ni-generation-and-supply-licences-i-sem-related>

- Chapter 4 sets out the UR's decisions on the proposal to introduce new conditions (i.e. the Capacity Market Code condition and the Balancing Market Principles Code of Practice condition in each of the categories of generation and supply licences; and
- Chapter 5 (Next Steps).

The licence modifications, showing a mark-up of changes from consultation to decision, can be found in Annexes to this document as follows:

- Annex 1: Modifications to 'standard' generator licences
- Annex 2: Modifications to all supply licences, including DSUs
- Annex 3: Modifications to 'DSU' generator licences
- Annex 4: Modifications to Power NI/ PPB licence only
- Annex 5: Modifications to AES Ballylumford Ltd generation licence only

Final versions of the licences will be published on the Utility Regulator website. The modifications to the licences will each take effect on 10 November (subject to the requirements contained therein for particular provisions to be brought into effect on later date(s) as may be specified by direction of the UR).

APPROACH TO CONSIDERATION OF RESPONSES

Of the ninety-eight licences affected by the modifications, the UR received six non-confidential responses from generators and suppliers; these are published alongside this document and were from:

- AES UK & Ireland³
- Bord Gais Energy
- Energia⁴
- ESB⁵
- Power NI
- PPB

We would like to thank all respondents for their informative comments and

³ AES UK & Ireland's response is on behalf of AES Kilroot Power Ltd and AES Ballylumford Ltd

⁴ Energia's response is on behalf of Altamuskin Wind Farm Ltd, Gortfinbar Energy Ltd, Long Mountain Wind Farm Ltd, Thornog Windfarm Ltd, Wheelhouse Energy (NI) Ltd, Viridian Energy Supply Ltd (Energia)

⁵ ESB submitted both a confidential (not published) and non-confidential (published) response. ESB's response is on behalf of ESB and all relevant ESB subsidiaries which are holder of generation (ie. Coolkeeragh, Hunters Hill, Carrickatane, Curryfree, Crockagarron and Crockandun) or supply (ie. ESB and ESBNI Ltd) licences in NI within the ESB Group.

feedback. In this decision paper, we set out a summary of the responses received alongside our reasoning and decision on each condition. We have taken into account, and considered carefully the representations made by each of these parties in forming our decisions on each of the proposed licence modifications.

The CER also received seven non-confidential responses to the statutory consultation in Ireland; the UR and CER have collaboratively considered all responses to each respective consultation carefully in the interests of policy-fit, consistency and alignment across the two jurisdictions.

The UR has accepted suggested amendments to some of the proposed licence modifications from respondents where they are minor editorial changes, sensible and helpful amendments to assist with clarification or interpretation.

There were no objections in respect of some proposals (e.g. the modification to move the definition of Intermediary).

Generally, the respondents' comments focused on the proposed introduction of the BMPCOP and the CMC conditions, as well as on the modification of the existing cost-reflective bidding condition.

Some respondents disagreed with the proposed modifications to the cost-reflective bidding condition and the proposed introduction of the BMPCOP and the CMC conditions as currently drafted. In general, these respondents raised a variety of legal and policy issues, mainly in relation to insufficient detail in the licence conditions, unlawful exercise of powers by the UR and recovery of eligible costs. In addition, some respondents provided suggestions in relation to the drafting of the new licence conditions (i.e. the CMC and the BMPCOP conditions).

Other comments to the proposed licence modifications include:

- Requests for clarity on some issues such as the timing of the Director's Certificate to be provided under the BMPCOP condition.
- Criticism of the decision not to increase the timelines for consultation beyond the statutory minimum
- Criticism of the UR's general approach to justification of licence modifications by referring to previous SEMC decisions
- Criticism of the UR's and SEMC's consultation and decision making approach

Some respondents suggested other additions or amendments to the existing

licence conditions which were not subject to the consultation published on 2 June 2017. Such modifications will therefore not form part of this decision. That would be contrary to the statutory process.

The UR ⁶ is publishing the licence modifications, acting on behalf of the SEMC, in Annexes 1 to 5 to this decision paper. The modifications to the licences will take effect on 10 November (subject to the requirements contained therein for particular provisions to be brought into effect on later date(s) as may be specified by direction of the UR.⁷

RELATED DOCUMENTS

The SEM Committee has published policy papers on key issues related to the implementation of I-SEM, which can be found on the SEM Committee website <https://www.semcommittee.com/>.

Below are the most recent documents reflecting SEM Committee policy decisions. Further information regarding recent developments in the SEM and SEM Committee policies are contained on the following websites www.semcommittee.com, www.cer.ie, www.uregni.gov.uk.

- Decision on Modifications to the SONI Market Operator Licence and SONI Transmission System Operator Licence, necessitated to implement the Integrated Single Electricity Market (1 July 2016);
- Decision on Modifications to SONI Market Operator Licence and Transmission System Operator Licence, necessitated to implement the Integrated Single Electricity Market (10 March 2017);
- Consultation Paper Offers in the I-SEM Balancing Market (SEM-16-059)
- Decision on Complex Bid Offer Controls in the I-SEM Balancing Market (SEM-17-020);
- BMPS Terms of Reference Decision Paper (SEM-16-058);
- Consultation on I-SEM Balancing Market Principles Code of Practice (SEM-17-026);
- Decision Paper BMPCOP (SEM-17-049)

⁶ Note that references in the paper to the UR are to the UR acting through its SEM Committee.

⁷ Should an appeal or challenge be made to the licence modifications, the statutory process and timeline will be followed in each jurisdiction respectively.

- Decision on I-SEM Trading and Settlement Code Amendments Decision Paper (SEM-17-024)
- Consultation Paper CRM CMC (SEM-17-004)
- Decision Paper CRM CMC (SEM-17-033)
- UR Consultation Paper on Proposed Modifications to Generation and Supply Licences (2 June 2017)

Information on the UR's role and relevant legislation can be found on the UR's website at www.niaur.gov.uk

2 NI electricity generator licence modifications (including DSUs) – existing conditions

This chapter sets out the UR's decisions on proposed modifications to existing conditions in the licences to generate electricity, granted under Article 10(1)(a) of the Electricity (Northern Ireland)(Order) 1992 (the "Order"). This includes NI electricity 'standard' generation licences 'DSU' generator licences and AES Ballylumford generation licence.

The UR's decisions in relation to the introduction of new licence conditions in the licences to generate electricity granted under Article 10(1)(a) of the Order are treated separately in chapter 4.

The proposed modifications will now be discussed in turn, to include an outline of the proposed modifications, summary of responses, UR's counter-response and UR's decision on behalf of the SEMC.

CONDITION 1: INTERPRETATION AND CONSTRUCTION / CONDITION 14 SINGLE ELECTRICITY MARKET TRADING AND SETTLEMENT CODE

Summary of proposed modification

It was proposed to remove the current definition of Intermediary from condition 1 and insert it into condition 14 in each of the licences so that the definition will only apply in the context of condition 14 Single Electricity Market Trading and Settlement Code.

It was also proposed to include a definition of Intermediary Agreement into condition 1 of the AES Ballylumford Generation Licence. That term is currently defined in condition 17 Cost Reflective Bidding which will (in due course) be switched off and the definition is required for the ongoing interpretation of other licence conditions.

Summary of responses

The UR did not receive any objections to either of the proposed modifications set out above.

UR position / decision

The UR's decision is to make the modifications as proposed.

CONDITION 17: COST REFLECTIVE BIDDING IN THE SEM

Summary of proposed modification

It was proposed to include a new provision stating that this condition would cease to have effect at a date (and subject to such transitional arrangements) as determined by the UR. The proposed modification is required to enable the UR to 'turn off' the application of this condition which will cease to have effect at the same point in time as the new proposed condition, Balancing Market Principles Code of Practice is to come into effect.

This modification was proposed in respect of all licences granted under Article 10(1)(a) of the Order.

Summary of responses

Energia objects to this proposed amendment on the basis that it is unnecessary given their objection to the introduction of the BMPCOP condition which is to replace this condition.

ESB do not agree with the proposed replacement of the current form of this condition with the introduction of the BMPCOP condition. They consider that the substantive bidding principles governing the bidding controls belong within the licence.

UR's position

The UR's reasoning for the replacement of the cost reflective bidding condition with the new BMPCOP condition is fully set out in chapter 4 below and covers the arguments set out above.

UR's decision

The UR's decision is to amend the conditions as proposed. This will enable the UR to switch off the condition at the same point in time as the BMPCOP condition is to take effect.

CONDITION 18: NOT USED

Summary of proposed modification

It was proposed to include a Condition 18 into those licences granted under Article 10(1)(a) of the Order which do not currently have a Condition 18. In such cases, the condition would be marked 'Not Used'. This was to enable the new CMC

condition to be positioned as Condition 19 across all licences granted under Article 10(1)(a) of the Order.

Summary of responses

No objections or representations were made.

UR's position / decision

The UR's decision is to modify the affected licences as proposed.

The track change version of the licence does not include this modification.

CONDITION 18: INTERMEDIARY AGREEMENT (AES BALLYLUMFORD LICENCE)

Summary of proposed modification

It was proposed to update this condition in the AES Ballylumford Generation licence so that it would refer to the new BMPCOP condition instead of the existing Cost Reflective Bidding (CRB) condition in due course when the BMPCOP condition replaces the CRB condition and also, to cross refer to the CMC condition.

Summary of responses

No objections or representations were received.

UR's position / decision

The UR's decision is to modify the licence condition as proposed.

Annexes

The licence modifications set out above can be found in the Annexes to this document as follows (shown as a mark-up of changes from consultation to decision):

- Annex 1: Modifications to 'standard' generator licences
- Annex 3: Modifications to 'DSU' generator licences
- Annex 5: Modifications to AES Ballylumford Ltd generation licence

Final versions of the licences will be published on the Utility Regulator website. The modifications to the licences will each take effect on 10 November (subject to the requirements contained therein for particular provisions to be brought into effect on later date(s) as may be specified by direction of the UR).

3 Decision on NI supply licence modifications – existing conditions

This chapter sets out the UR's decisions on proposed modifications to existing conditions in the Power NI (PPB) supply licence granted under Article 10(1)(c) of the Order.

The UR's decisions in relation to the introduction of new licence conditions into the Power NI (PPB) supply licence and all other supply licences granted under Article 10(1)(c) of the Order are treated separately in chapter 4.

The proposed modifications will now be discussed in turn, to include an outline of the proposed modifications, summary of responses, UR's counter-response and UR's decision on behalf of the SEMC.

CONDITION 57: COST REFLECTIVE BIDDING IN THE SINGLE ELECTRICITY MARKET

Summary of proposed modification

It was proposed to include a new provision stating that this condition would cease to have effect at a date (and subject to such transitional arrangements) as determined by the UR. The proposed modification is required to enable the UR to 'turn off' the application of this condition which will cease to have effect at the same point in time as the new BMPCOP comes into effect.

Summary of responses

No representations or objections were received from Power NI (PBB), specifically in relation to the proposed deletion of this condition. Representations were made in relation to the introduction of condition 57a BMPCOP. These are set out in chapter 4 below.

UR's position / decision

The UR's decision is to amend the condition as proposed. This will enable the UR to switch off the condition at the same point in time as the BMPCOP condition is to take effect.

CONDITION 59: INTERMEDIARY AGREEMENTS

Summary of proposed modification

It was proposed to update this condition by replacing the existing reference to the Cost Reflective Bidding condition with reference to the BMPCOP condition and also, to refer to the CMC condition.

Summary of responses

PPB stated some concerns with regard to the approach taken to giving effect to the deletions to this licence condition. PPB commented that this approach had not been used elsewhere in this set of licence modifications and made some alternative drafting suggestions.

UR's position

The UR notes PPB's concerns, however, it is satisfied as to the robustness and clarity of its approach and would highlight that this approach whilst not used in this set of licence modifications (because there are no other conditions being modified in this way) has been used in relation to other tranches of I-SEM licence modifications.

UR's decision

The UR's decision is to modify the condition as proposed.

Annexes

The licence modifications set out above can be found in Annex 4 to this document (shown as a mark-up of changes from consultation to decision):

Final versions of the licences will be published on the Utility Regulator website. The modifications to the licences will each take effect on 10 November (subject to the requirements contained therein for particular provisions to be brought into effect on later date(s) as may be specified by direction of the UR).

4. Decision on the proposal to introduce new licence conditions

This chapter sets out the UR's decisions on the proposal to introduce new conditions in the 'standard' generator licences, all supply licences (including the DSUs), the 'DSU' generator licences, the Power NI/PPB licence and the AES Ballylumford Ltd generation licence.

These new conditions are the CMC condition and the BMPCOP condition. Respondents, broadly, put forward similar arguments in respect of this proposal in relation to all of the classes of licence being modified; therefore, these are dealt with under the same chapter, to avoid repetition.

These proposed modifications and supporting rationale were detailed in the statutory consultation paper published on 2 June 2017. The final modifications are reflected in the track-changes version of the licences, annexed to this decision, showing a mark-up of changes from consultation to decision. The licence modifications set out in this licence will apply to all effected licences granted under Article 10(1)(a) or (c) of the Order.

The UR's decisions in relation to proposed modifications to existing conditions in the various classes of licence being modified are treated separately in chapters 2 and 3 of this paper.

COST RECOVERY / MARKET DESIGN

A number of concerns raised by respondents in relation to the two proposed new licence conditions relate fundamentally to the impact of the I-SEM market design (as reflected in those conditions) on the ability of existing generators to earn sufficient revenues to cover their costs. These concerns were expressed with respect to specific generation plant that may be selected both in the Capacity Remuneration Mechanism (CRM) to meet local capacity requirements and that are constrained-on in the Balancing Mechanism (BM), under non-energy actions, to meet system constraints to a very material degree, or only generates in response to a non-energy action.

This section of the chapter addresses the RAs underlying rationale for these market design decisions in order to remind stakeholders of the context within which the two new licence modifications are being implemented.

The primary objective of the RAs in designing and implementing the new capacity and energy market arrangements is to act in the interests of customers wherever appropriate by promoting effective competition, and where effective competition is not possible, to implement regulatory oversight that mimics the outcome of a

competitive market. In pursuing that objective the UR must, of course, have regard (amongst other things) to the need to ensure that market participants are able to finance their activities and to the need to ensure security of supply.

The UR's task as economic regulator is to assess the extent to which allowing the recovery of particular costs is consistent with our overall objective and our statutory duties. One consequence of that, as has been stated in a number of consultation and decision papers⁸, is that market revenues may not be high enough to enable existing generators to recover certain costs (such as sunk costs) which they might otherwise wish to include in their bids into the BM and/or the CRM. However, the rationale for bids into the BM, for instance, to be based on short run marginal costs (and should not include sunk costs) is set out in the various consultation and decision papers.

In seeking to achieve as far as possible the outcome that would prevail in a competitive market, operators with higher costs, whether for historic reasons or otherwise, will earn a lower return than lower cost and/or more efficient operators. Such an outcome is entirely consistent with the proper performance of our statutory duties and with the wider legal requirements which respondents have identified.

The I-SEM market design recognises that not all aspects of the market will be fully competitive, and incorporates a set of regulatory measures (notably in the CRM and bidding controls regime) designed to mitigate the exercise of market power capable of being exercised by incumbents, as well as measures designed to stimulate new entry. These measures have been developed in a series of decisions, including (as regards the CRM) the Decision Papers on CRM Parameters and Auction Timings (SEM-17-022) and on the Capacity Market Code (SEM-17-033)⁹ and (as regards the bidding controls regime) the Decision Papers on Complex Bid Offer Controls in the BM (SEM-17-020) and on the Balancing Market Bidding Code of Practice (SEM-17-048), which each take legal effect in accordance with their terms.

It is only to be expected that existing generators will be impacted (and impacted differently to others) to some extent by such measures. Whilst the UR's task as economic regulator seeks to maintain a level playing field, it is the nature of

⁸ In SEM-17-020, for instance, it was stated, "*The SEM Committee is clear, given that complex bid offer controls are designed to ensure that complex bid offer data reflects short run marginal cost, that such controls should not permit the inclusion of sunk costs in such bid offer data*" (paragraph 3.5.13). And in SEM-17-022 it was stated, "*The SEM Committee considers that [...] the approach of not including sunk costs in NGFCs and hence USPCs is central to controlling market power in the first transitional auction*" (paragraph 6.3.43).

⁹ Decision made under Condition 23A (Capacity Market) in the SONI TSO licence (and the corresponding condition in the EirGrid licence).

regulation of the market that some such differential impacts cannot be avoided and the UR, as regulator, take them properly into account in pursuing its statutory objective and in considering the matters discussed above.

It is also important to emphasise that the I-SEM market design will allow existing generators who are likely to be called upon to offer capacity in the CRM or to generate in response to requests for non-energy actions in the BM to recover not simply the costs reflected in their bid prices, but also the infra-marginal rent available within the capacity and balancing market clearing prices. In addition flexibility is being built into the I-SEM market design (such as in relation to the Unit Specific Price Cap mechanism) to allow general provisions on cost recovery to be adjusted, where appropriate, to accommodate the particular circumstances of individual generators.

Nonetheless, participation in a regulated market, such as the I-SEM (or the SEM for that matter), necessarily involves submitting to a regulatory regime (with associated regulatory obligations) which is not static, but has to evolve in order to meet changing circumstances, including the competitive environment and the presence of market power. Market participants are able to choose, in response to such changes, whether to remain part of that market and accept the associated ongoing regulatory obligations and costs or to exit the market, subject to compliance with the obligations (and costs) associated with exit. In that context, generators are entitled to approach the TSOs as regards the seeking of derogations from the Grid Code requirements concerning exit from the market.

Whilst the RAs are satisfied with the constraints on cost recovery which have been included, in the interest of market power mitigation, in the design of the CRM and in the bidding controls regime (and are reflected in the two proposed new conditions), they recognise that generators seeking to exit the market may, in light of the three year notification requirement for closure under the Grid Code, face financial burdens which are not covered by I-SEM market revenues (particularly in the case of plants where a derogation from that requirement may compromise local security of supply). As stakeholders are already aware, the TSOs have been requested to develop an appropriate framework for any additional mechanism to address particular local security of supply concerns, taking account of the overall energy, capacity and system services market arrangements and relevant Grid Code requirements.

The proposed new conditions will now be discussed in turn, to include an outline of them, summary of responses, UR's counter-response and UR's decision on behalf of the SEMC.

CONDITION 19 / CONDITION 25B / CONDITION 58A: CAPACITY MARKET CODE CONDITION

Summary of proposed modifications

A proposed new condition requires licence holders to sign up to and comply with the Capacity Market Code insofar as applicable to them. Whilst the licence condition is to be incorporated into 'standard' generator licences, all supply licences (including the DSUs), the 'DSU' generator licences, the Power NI/PPB licence and the AES Ballylumford Ltd generation licence, in practical terms, in the context of electricity suppliers, the obligations to comply with the Code (and in turn, the licence condition) will be most relevant for those suppliers that elect to offer demand side response into the capacity market.

Summary of responses

The UR received a number of representations in respect of the proposed CMC condition.

Energia strongly objected to the new proposed licence condition on the basis that they consider it to be insufficiently detailed and flagged a number of matters that it believes should be covered in the condition. Energia also argued that the approach taken in respect of the new CMC condition is, in a variety of ways, unlawful (e.g. it is contrary to the UR's statutory duties and relevant case law, it risks breaching market participants' property rights, it breaches competition law, it is insufficiently certain and undermines generators' rights).

ESB also did not support the proposed CMC condition in its current format and believe that the condition must include the principles governing the operation of the capacity market and the key rights afforded to generators when offering their capacity to this market.

Bord Gais Energy commented that there are certain differences between the versions of the new condition being introduced in NI and its equivalent in ROI.

Power NI commented that the language used in proposed new condition 58a in its supply licence differs from 25b in the generation licence and should instead be consistent across all licences. The differences are: paragraph 1 of condition 58a includes obligations on the licensee to 'enter into and at all times remain a party to' and 'comply with its obligations under' the CMC whereas paragraph 1 of condition 25b provides that the licensee 'shall be party to, and shall comply with' the CMC. Also, paragraph 2 of condition 58a specifies that 'Different days may be so appointed for different provisions and for different purposes' whereas this is not mentioned in paragraph 2 of condition 25b.

PPB also raised the fact that the term 'Capacity Market Code' is used in condition 58a of the supply licences without definition.

In addition, PPB also noted that there is an obligation on the relevant licensee to be party to and comply with the CMC 'insofar as applicable to it'. They believed that clarity should be provided in the CMC itself when an entity is actually required to be a party to it.

UR's response

Need for CMC Principles

The UR notes the various representations received in relation to the alleged absence of principles to govern the Capacity Market Code and to protect the interests of participants in the capacity market, for instance in relation to the issue of cost recovery.

The UR considers such allegations to be wholly misconceived. It should be pointed out, as a preliminary point, that the CMC (and, thus, the auction and other rules which it contains) is in fact subject to a set of governing principles in the form of objectives which are set out paragraph 4 of Condition 23A of the SONI TSO licence. These objectives are:

- to facilitate the efficient discharge by SONI of the obligations imposed on it by the TSO licence, and to facilitate the efficient discharge by the ROI TSO of the obligations imposed on it by its licence;
- to facilitate the efficient, economic and coordinated operation, administration and development of the Capacity Market and the provision of adequate future capacity in a financially secure manner;
- to facilitate the participation of undertakings including electricity undertakings engaged or seeking to be engaged in the provision of capacity in the Capacity Market;
- to promote competition in the provision of capacity to the SEM;
- to provide transparency in the operation of the SEM;
- to ensure no undue discrimination between persons who are or may seek to become parties to the Capacity Market Code; and
- through the development of the Capacity Market to promote the short-term and long-term interests of consumers of electricity with respect to price, quality, reliability, and security of supply of electricity across the island of Ireland.

Paragraph (1) of that condition requires SONI to enter into and, in conjunction with EirGrid, at all times administer and maintain in force, the CMC, which is required to be a document which: (a) makes provision in respect of the capacity arrangements described in paragraph (3) of the condition; (b) is designed to facilitate achievement

of the objectives described above; and c) contains modification procedures which provide that any modifications to the CMC must be subject to the prior approval of the UR and which enable the UR to propose modifications to the CMC.

Paragraph (1) also provides that SONI is to be taken to have complied with the requirements described in the previous paragraph to the extent that it adopts, on the date of such designation, as the CMC the document designated as such by the UR for the purposes of Condition 23A¹⁰ and, on an on-going basis, reviews and proposes such modifications to that document (in accordance with the modification provisions therein) as would be necessary to ensure that that document meets those requirements.

The UR's final decision in respect of condition 23A was taken in a decision published on 10 March 2017, following on from an earlier decision of 1 July 2016. Those decisions were each preceded by a public consultation exercise (opened on 16 December 2016 and 20 April 2016 respectively) to which a variety of market participants responded.

Those papers represented the culmination of a lengthy process of engagement concerning the institutional and governance arrangements for the Capacity Remuneration Mechanism which included SEM-15-016 on Roles and Responsibilities as well as Consultation Paper SEM-15-044 and Decision Paper SEM-15-103 on Capacity Remuneration Mechanism Detailed Design.

Respondents will also be familiar with the detailed governance provisions which must be complied with in the event of proposals to modify the Capacity Market Code¹¹.

The UR completely rejects therefore the suggestion that the obligation to be party to, and to comply with, the CMC is in any sense 'open ended'. On the contrary, the governance provisions highlighted above substantially control and constrain the ability of the TSOs (and the RAs) to impose obligations on participants in the I-SEM capacity market. Not only that, but those provisions were developed in consultation with market participants, thus allowing legitimate concerns regarding, for instance, cost recovery to be accommodated.

Additional legal concerns

¹⁰ Designation of the CMC was undertaken by each of the Regulatory Authorities pursuant to decision of the SEM Committee approving the CMC contained in Decision Paper SEM-17-033 published on 2 June 2017.

¹¹ See section B.12 of the Capacity Market Code.

The UR notes the additional legal concerns which were raised in connection with the alleged absence of principles to govern the Capacity Market Code (i.e., (a) vagueness or failure to provide legal certainty, (b) ultra vires the UR's statutory powers and duties, (c) circumvention of the statutory governance and accountability framework and unjustifiable undermining of generators' rights, (d) superseding of relevant case law, (e) inconsistency with a generator's right to property and (f) conflict with competition law) and notes that these concerns closely resemble the arguments (described below) raised against the proposed BMPCOP condition.

To that extent, the UR adopts the same position in relation to those arguments in the context of the CMC and the proposed licence condition requiring adherence to and compliance with that code as it does in the context of the BMPCOP and the proposed BMPCOP condition. See below.

In relation to those arguments concerned specifically with necessity and proportionality, and the question of whether the proposed licence condition can be considered necessary for I-SEM implementation, the UR also wishes to add that the need for a licence condition of the type proposed was identified as long ago as SEM-15-044 (CRM Detailed Design). In that Consultation Paper the SEM Committee pointed out that, should the CRM be mandatory for existing licence holders in Ireland and Northern Ireland (as, of course, it was subsequently decided to be), the RAs would amend generation and supplier licences to require accession to the capacity market rules and prequalification for auction. The need for those licence conditions in light of the decision on mandatory participation was, in turn, confirmed in section 3.1 of SEM-17-033 (CRM CMC Decision Paper).

Other drafting points

In terms of any drafting differences between the NI and ROI versions of this new condition, the UR is of the view that these have no substantive effect and the scope of the obligations on NI and ROI generators will be the same. The differences are simply to reflect the different structure of the corresponding licences in each jurisdiction, so that the new conditions in NI licences follow a consistent approach with existing licence conditions within the same licence.

In terms of the differences which exist between proposed condition 58a in Power NI's supply licence and proposed condition 25a in the standard supply licence, the UR is content to accept the proposed change to paragraph 2 of condition 58a (i.e. the deletion of the words "*Different days may be so appointed for different provisions and for different purposes.*"). This will not have any substantive impact in the context of this licence condition. The UR also agrees that a definition of "Capacity Market Code" should be included in Condition 58a. These changes are reflected in the new conditions in Annex 4.

The UR does not believe, however, that any changes would be appropriate or necessary in respect of paragraph 1 of proposed condition 58a Power NI's supply licence. The difference in terminology is to ensure consistency of legal drafting within the licence. The proposed CMC condition is aligned with the structure of the TSC condition for the PPB.

In respect of a perceived lack of clarity flowing from the use of the phrase "*insofar as applicable to it*" in paragraph 1 of proposed CMC condition, this simply reflects the fact that the CMC will not apply to all market participants all of the time. The UR considers that the existing drafting accurately captures the extent of the licensee's obligation and, therefore, sees no need to amend this text. Licensees shall be able to ascertain the extent of their obligations as regards the CMC by reviewing the Code itself.

UR's decision

The final modifications are reflected in the track-changes version of the licences (showing a mark-up of changes from consultation to decision) published alongside this Decision Paper in Annexes 1-5.

This includes a minor modification to paragraph 2 in each of Annexes 1 and 3 to make it clear that the obligation to be party and comply with the CMC in relation to Intermediaries is only "insofar as applicable to [them]".

CONDITION 17A / CONDITION 25A / CONDITION 57A - BALANCING MARKET PRINCIPLES CODE OF PRACTICE CONDITION

Summary of proposed modifications

A proposed new licence condition requiring the licensee to comply with the BMPCOP when formulating and submitting Commercial Offer Data (COD) in the Balancing Market.

The proposed condition makes provisions for the UR (acting jointly with the CER if it elects) to publish the BMPCOP and amend it following consultation. It also provides that the BMPCOP will (a) apply only to those categories of COD which are specified in it from time to time and (b) make such provision as appears requisite to the UR to ensure such data are cost reflective. The proposed condition will also give the UR power to issue directions to licensees to secure compliance with the licence condition and the BMPCOP.

Summary of responses

A number of concerns were raised by several respondents, including:

- An overarching concern by several respondents that the proposed drafting of the condition would empower the RAs to amend the BMPCOP

from time to time following consultation which would remove the right of appeal in relation to future changes to bidding rules, separate from the detailed licence modification procedure as set out in Articles 14 and 14A-G of the Order (one respondent also referred to Article 37(17) of the Internal Market in Electricity Directive in this regard, which states that “*suitable mechanisms exist at a national level under which a party affected by a decision of a regulatory authority has a right of appeal*”);

- A concern that the RAs would be empowered to issue directions to licencees to ensure compliance with the condition and the BMPCOP;
- The approach to cost recovery is too prescriptive and at odds with the workings of a competitive market; and
- A number of respondents commented on the drafting of the BMPCOP itself. Bord Gais Energy suggested various amendments to the content of the BMPCOP document. ESB were also concerned about the proposed content of the BMPCOP.

Bord Gais Energy were generally satisfied with the proposed condition but prompted clarity on the drafting of paragraph 8 of licence condition 17a in AES’s generation licence compared to paragraph 8 of licence condition 57a of the Power NI supply licence (which falls within the PPB section of that licence).

Bord Gais Energy sought clarity as to what party is deemed responsible for complying with / breaching the BMPCOP condition and how would such a potential breach be rectified or compliance with the licence condition be enforced? This point is particularly relevant in the context of condition 17a(8) of the AES Ballylumford (Power) Ltd generation licence, which provides that AES does not need to comply with the BMPCOP licence condition for units for which PPB is acting as Intermediary. The entity on which responsibility for compliance with the BMPCOP condition falls is unclear. We note that the drafting included reflects the existing split of responsibility between AES / PPB under CRB condition.

Bord Gais Energy also sought clarity on when the first director certificate will be required to be signed and its form.

Power NI were of the view that the BMPCOP should form part of the actual licence condition so that the statutory modification and appeals procedure applies.

PPB also objected to the proposal to restructure the regulatory framework to move elements currently defined within the licence to a subsidiary document.

Power NI and PPB suggest that paragraph 2 of the BMPCOP condition is incorrect in nature since functions cannot be conferred on the UR by way of a licence condition.

Energia were strongly of the view that that the new condition is not necessary to facilitate I-SEM, was in conflict with a number of legal requirements and *ultra vires* the UR's statutory powers. In particular, Energia strongly objects to the proposed new licence condition due to:

- Vagueness / failure to provide legal certainty;
- It is ultra vires the UR's statutory powers and duties;
- The approach seeks to circumvent the statutory governance and accountability framework and unjustifiably undermines market participants' rights;
- It is potentially inconsistent with market participants' rights to property as protected under Article 1 of Protocol 1 of the European Convention on Human Rights;
- A belief that it may place market participants in direct conflict with competition law, specifically Article 102 of the TFEU and Chapter II of the Competition Act 1998.

Energia also offered criticism of the UR's approach to decision making, in particular:

- Criticism of the decision not to increase the timelines for consultation beyond the statutory minimum
- Criticism of the UR's general approach to justification of licence modifications by referring to previous SEMC decisions
- Criticism of the UR's and SEMC's consultation and decision making approach

A number of other participants made similar legal points to those made by Energia.

UR's response

Approach to decision-making

The UR notes the various criticisms levelled at the approach taken to consultation on the two proposed licence conditions, notably as regards the justification of proposals by reference to previous decisions of the SEM Committee and as regards the limited time made available for formulation of consultation responses.

The UR is wholly satisfied that its approach has been a fair and robust one, having regard to applicable statutory and other requirements.

As regards the reference by the UR to previous decisions of the SEM Committee, it is important to recognise that, in line with the allocation of responsibilities under the Order, the proposals being consulted upon are designed to give effect to those previous decisions. It is only to be expected, therefore, that the UR would wish to refer to those previous decisions in articulating those proposals and to have regard to them in evaluating the responses which have been received on them.

Turning to the criticism of the time made available for responses, it is important in the UR's view to take account of the various previous opportunities that have been afforded to stakeholders for commenting at various stages of policy formulation. The UR also notes that no allegations have been made of any specific detriment suffered by respondents as a result of the time made available.

Impact on cost recovery

The UR notes the various concerns expressed by respondents as regards the impact of the proposed licence condition on their ability to recover costs, such as by allowing costs to be defined in the BMPCOP, allegedly requiring pricing of bids below cost, by depriving generators of their property rights and also contributing to the abuse of market power (potentially contrary to competition law).

As regards the supposed risk of allowing for costs to be defined in the BMPCOP, the UR notes that the existing licence condition concerned with cost reflective bidding in the SEM already creates extensive scope for the definition of cost components in a subsidiary code. Whilst the range of material which may be defined in the BMPCOP may be more extensive in comparison, that difference should not, in the UR's opinion, create any materially greater risk to cost recovery than the current arrangements.

Nonetheless, the UR considers that there would be merit in providing some additional prescription in the proposed licence condition as regards the cost recovery standard to be applied by the UR in developing the BMPCOP (and reflecting the approach already evident on the face of the BMPCOP document¹²).

Turning to the criticism that the licence condition (and BMPCOP) may result in licence holders being unable to recover their costs and in the violation of their property rights, the UR would first of all refer to its earlier comments concerning cost recovery and I-SEM market design. The proposition that a generator may have costs which are, in certain circumstances, legitimately recoverable does not

¹² See paragraph 2 of the BMPCOP published in SEM-17-048

logically lead to the conclusion that such costs must necessarily be recovered via bids submitted into the BM. Equally, the inability of a generator to recover particular costs in those bids does not mean that it will necessarily be prevented from recovering its costs in another way or via some other mechanism.

The bidding controls regime established by the proposed licence condition is designed to ensure the recovery of those short run marginal costs which would be reflected in BM bids in the absence of market power. In the UR's view, the requirement that costs which may be recovered in BM bids reasonably reflect those short run marginal costs recoverable in a competitive market is entirely consistent with the requirements of competition law (and with the respect for the property rights of bidders), when viewed within the context of the I-SEM market design taken as a whole and, in particular, those market power mitigation measures forming part of the overall design.

Application to plant without market power

In response to the concerns expressed regarding the application of the bidding controls regime to some plant which may not necessarily enjoy temporal or locational market power, the UR refers to the points made in SEM-17-020 section 3.4 on this issue.

Due to the uncertainty around the location and timing of system constraints, bidding controls will be applied to all generation units' complex bid offer data, in order to protect I-SEM customers from the potential risk of abuse from temporal and locational market power, with the result that some 'early energy' actions (as well as non-energy actions) will be regulated under the BMPCOP.

The SEM Committee previously concluded that it would not be technically feasible at present to distinguish these different actions and that, pending the development of a technical solution and taking into account the mitigating factors mentioned in section 3.4 of SEM-17-020, the mitigation of market power risks in respect of non-energy actions is sufficiently important to justify the application of controls to all complex bid offer data submitted by generators.

Necessity, proportionality and consistency

The UR notes the concerns expressed by respondents concerning the necessity of the proposed licence condition, the proportionality of the approach being adopted and its inconsistency with previous decision-making.

These concerns have, in the UR's view, been taken fully into account in the approach taken to the development of I-SEM policy in this context. The need for a bidding controls regime of the sort now proposed (and the merits of that regime relative to those of other approaches, including a so-called 'minimal change' option)

was examined by the SEM Committee in an extensive consultation and engagement exercise which involved, notably, a consultation which commenced in November 2015 with the publication of a consultation paper on I-SEM Market Power Mitigation (SEM-15-094), followed by a decision paper on I-SEM Market Power Mitigation (SEM-16-024) in May 2016. Both of those papers explored in detail the rationale for ex ante bidding controls in the I-SEM along with other market power mitigation measures and did so explicitly within the context of the detailed design of the proposed regime, was considered by the SEM Committee in the process leading up to SEM-17-020 and SEM-17-048. This approach has enabled the adoption of a regime that satisfies all applicable requirements, whether in terms of the UR's relevant statutory duties (including those requiring regard to be had to economy and efficiency) or wider considerations, such as those of proportionality or good regulatory practice.

As regards the question of consistency, the UR understands the importance of acting consistently and is committed to doing so. However, the duty to act consistently applies to a given set of circumstances. To the extent that those circumstances change (as is the case with the introduction of the I-SEM and the development of a bidding controls regime suited to it), previous decisions and decision-making practice may remain relevant but cannot, and should not, be mechanically applied to the new situation.

Discretion conferred by licence condition

The UR notes the concerns which have been expressed concerning the extent of the authority conferred on it by the proposed licence condition.

As previously explained by the SEM Committee, the extent of authority conferred by the proposed licence condition is considered necessary to facilitate the creation of a dynamic BMPCOP document for I-SEM that can give greater clarity to industry regarding eligible costs, particularly given the evolving nature of energy markets and the growth in new generation technologies. The proposed approach means that, in the future, doubts as to the meaning or application of the BMPCOP can be definitively resolved by the SEM Committee and recorded in the BMPCOP document, which would be updated by the SEM Committee to reflect particular circumstances following the appropriate consultation process. As noted previously, from a consumer interest perspective, and a market design and market power perspective, it is reasonable and prudent to have a framework that allows timely amendments to any future BMPCOP document should potential deficiencies arise or need for changes be identified.

Alleged frustration of appeal rights and ultra vires action

The UR notes the allegations that the discretion conferred on it as regards the making and revision of the BMPCOP would frustrate existing rights of appeal, or would otherwise be unlawful or ultra vires.

It is worth reminding respondents that the existing cost reflective bidding condition which applies in the SEM already confers substantial authority on the UR to make provision via a subsidiary code. Whilst the range of material which may be defined in the BMPCOP may be more extensive in comparison, there is no substantive legal difference between the two situations, whether in terms of the availability of statutory appeal rights or the availability of statutory vires. In neither situation, in the UR's view, is there any question of frustrating such rights or exceeding such vires¹³.

It should also be remembered, as previously pointed out by the SEM Committee, that the UR is a 'creature of statute' and is required to comply with the same statutory duties (e.g., as to the financing of licensed activities) when making decisions in relation to a subsidiary document such as the BMPCOP as when it is taking decisions to modify licence conditions.

The UR also notes the reference by one respondent to Article 37(17) of the Internal Market in Electricity Directive in respect of the alleged frustration of licensees' appeal rights. Article 37(17) states that "*suitable mechanisms exist at a national level under which a party affected by a decision of a regulatory authority has a right of appeal*". Given the ongoing availability of both the statutory appeal rights and judicial review, the UR cannot see the proposed new licence condition can, on any sensible interpretation, be said to breach Article 37(17).

Nonetheless, as indicated above, the UR does consider that there would be merit in providing some additional prescription in the proposed licence condition as regards the parameters within which discretion is to be exercised by the UR in developing the BMPCOP. In addition, the UR also considers that the proposed licence condition should explicitly respect the change management provisions included within the version of the BMPCOP published in SEM-17-048, so as to underscore the UR's commitment to accountability in respect of future revisions of the BMPCOP.

¹³ Respondents have referred to previous case law (specifically, *Viridian and Endesa v. CER* (2011)) as authority for the proposition that the UR lacks vires to establish the BMPCOP arrangements. In particular, *Energia* argued that notwithstanding the specific Irish statutory context within which this matter was decided, the general proposition remains applicable to the regime in Northern Ireland. However, as previously discussed by the SEM Committee, whilst that case law rightly identifies a need for a delegate to respect the extent of the authority delegated to it, there is nothing in that case law to suggest a substantive limit on the extent of authority to be delegated, at least to the extent relevant in the present context.

Lack of legal certainty

The UR notes the concerns which have been expressed concerning the lack of legal certainty provided by the proposed licence condition (given the extent of the delegated authority which it contains).

The UR considers that the question of legal certainty must be assessed by taking the terms of both the proposed licence condition and the BMPCOP into account, since it is only by doing so that the nature and extent of the legal obligations imposed on market participants can be properly understood. The SEM Committee has taken care to share its thinking on the development of the BMPCOP in the process of engagement leading up to the publication of SEM-17-048. As a result, market participants have now been provided with considerable clarity and certainty as to the nature and extent of the obligations to which they will be subject.

Certification requirement

The UR recognises that the provisions of paragraph 8 of the proposed condition leave open the question as to the period to be covered in the first directors' certificate of compliance to be furnished after the licence condition comes into effect.

Having considered how best to resolve the uncertainty, the UR has decided that it will specify, in the directions bringing the condition into effect, that the period to be covered in the first certificate will run from the date of coming into effect until 31 March 2019.

Licence condition conferring functions on UR

The UR notes the view of some respondents that functions cannot be conferred on the UR by way of a licence condition. We do not consider this to be a robust argument. Framing licence conditions in the way that has been proposed in the BMPCOP condition (i.e. including obligations for the UR to discharge) is a common method used to create the necessary legal architecture for licensee's rights and obligations to work appropriately. The UR's view is that a reasonable interpretation of the applicable provisions of the Order allows for such an approach to be taken.

Additional changes to the BMPCOP

The UR notes that various suggestions (mentioned above) were made in response to the consultation as to changes which might be made to the BMPCOP before its finalisation. The UR also notes that market participants and others were provided with an opportunity to comment on the terms of the BMPCOP in a consultation which closed during the course of May 2017. This consultation exercise resulted in the publication of the finalised BMPCOP (SEM-17-049) on 11 July 2017.

The UR notes that the comments concerning the BMPCOP submitted in relation to the proposed licence condition do not raise any points which were not also raised by respondents to that earlier consultation exercise on the BMPCOP itself. To that extent, the points raised have already been taken into account by the SEM Committee in finalising the terms of the BMPCOP.

UR's decision

As indicated above, the UR has decided in light of representations received from respondents to adjust the text of the final licence condition so as to provide further specification as regards the parameters for UR decision-making in respect of the BMPCOP. Accordingly, the provision in paragraph (2)(b) of the proposed text (which guides the UR's discretion in making (and revising) the BMPCOP) which referred to Commercial Offer Data being "cost reflective" has been changed so as to refer to Commercial Offer Data which, "reasonably reflect the short run marginal cost of operating the generating unit to which they relate", and also to make explicit that the purpose of the BMPCOP is to facilitate the efficient operation of the BM by contributing to the mitigation of market power in the I-SEM.

In addition, as also indicated earlier, the UR has decided in light of representations received to specify in a new paragraph (3) of the condition that any future modification of the BMPCOP should respect any additional change management provisions included in the BMPCOP itself (which currently requires, for instance, a call for evidence).

Finally, the wording of paragraph (1) of the proposed condition which contained a potentially confusing duplication of the verb "ensure" (in relation to compliance with the BMPCOP) has been changed so as to refer instead to licence holders having to "secure" compliance with the BMPCOP. The change does not materially alter the meaning or effect of the paragraph.

In addition to the changes mentioned above, the final modifications also correct certain minor typographical errors contained in the proposed text of the proposed new Condition 57a in the Power NI/ PPB electricity supply licence as follows:

- Amend paragraph 1 to include the words "*whether by the Licensee itself or by any person acting on its behalf*".
- Include a definition of "Balancing Mechanism".

The final modifications are reflected in the track-changes version of the licences, annexed to this decision, showing a mark-up of changes from consultation to decision. The licence modifications set out in this licence will apply to all effected licences granted under Article 10(1)(a) or (c) of the Order.

5 Next Steps

In line with the statutory modification process, the licence modifications described above (and shown in the Annexes) will come into effect on 10 November (56 days after publication of the decision in NI) (subject to the requirements contained therein for particular provisions to be brought into effect on later date(s) as may be specified by direction of the UR).