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SEM Committee
5 May 2023

To -
Emer Gerrard
Simon O'Hare.

Dear SEM Commitee

The Single Electricity Market Operator (SEMO) welcomes the opportunity to respond to the Single Energy Market Committee's (SEMC) consultation on **Compensation Arrangements for Net Transfer Capacity Reductions (ref: SEM-23-024)** dated 15 March 2023.

As the Single Market Operator for the continuous operation and administration of the Single Electricity Market (SEM) on the island of Ireland, SEMO promotes the adoption and use of transparent and unambiguous rules for market participants interacting within the market. This includes rules associated with how capacity is managed within the SEM and the relevant rules for compensation.

The SEMC's consultation paper is timely given the large-scale expansion of the SEM, with two new interconnectors due to come on stream over the next 3 years. These interconnectors will help the system meet the challenging goal of operating the power system at 80% renewables by 2030, with up to 95% of instantaneous generation coming from variable renewable sources.

SEMO is committed to working with the Regulatory Authorities (RAs), market participants and Interconnector Owners (ICOs) to ensure a fair and competitive framework exists that benefits the end customer and makes the SEM an attractive zone for investment. We have responded below to all questions relevant to SEMO in its role as Market Operator for the SEM.

Questions & SEMO responses

1. **Please set out your view on the appropriate arrangements for NTC reduction compensation going forward in the SEM, given the current arrangements for cross-border trading. Would this be impacted if cross-border forward hedging instruments were introduced in advance of MRLVC and, if so, why?**

SEMO notes that the Interim Cross Zonal Arrangements (ICZA) provided a stable framework for the introduction of new market arrangements in 2018 across many areas. However, SEMO believes those sections pertaining to compensation arrangements in the event of a reduction in Net Transfer Capacity (NTC) lack sufficient detail to be an effective transparent framework for managing situations where claims for compensation may arise.

The ICZA, as expressly stated by the RAs in the ICZA covering letter[1], was designed as an interim solution:

[1] Available here

"*The enduring arrangements relating to cross-zonal TSO arrangements, dictated by CACM Regulation (EU) 2015/1222, will not be in place to meet the I-SEM go-live date. As such it was necessary to develop interim arrangements across the Ireland UK (IU) region that support(s) the achievement of the I-SEM go-live objectives and at the same time do not in any way hinder the achievement of the objectives of the CACM and/or FCA Regulation 2016/1719*".

As such, SEMO believes the adoption of the regulatory obligations expressly provided for in CACM[2] and FCA[3] would not only provide clarity on this issue but would also be in keeping with the spirit and intent of the ICZA.

In this context, SEMO notes that Article 3 of CACM provides as one of its aims "*ensuring fair and non-discriminatory treatment of TSOs, NEMOs, the Agency, regulatory authorities and market participants*". Unambiguous compensatory rules are therefore critical in our view in order for the satisfactory implementation of this objective of CACM.

In the context of this non-discriminatory objective of CACM, SEMO raises a number of points below. If rules around compensation do not provide transparency to ICOswhen allocated capacity is restricted, then there is a risk that this will provide negative investment signals within SEM for future interconnection projects.

SEMO is particularly concerned with any proposed resolution of this issue by the SEMC that would have the effect of increasing the risk of consumers being impacted by higher Dispatch Balancing Costs. This risk may materialise for example if the TSO is not properly incentivised to act (while respecting the EU legal framework applicable to TSOs) to quickly resolve within zone capacity adequacy issues in advance of Ex-Ante market coupling.

We also assume that TSO reduction of cross zonal capacity is a last resort activity after all other TSO remedial action options (including, by way of example, counter trading and redispatch) have been exhausted. Nothwitstanding this point, we understand the need for ICOs to have certainty in relation to the relevant compensatory methodology for NTC reductions in place within SEM from an investment perspective.

In the European regulatory context, CACM appears to already manage the above issue by:

(a) allowing TSOs to set out its methodologies for how its actions will apply to capacity calculation in advance of allocation (see e.g. Articles 23 to 25 (inclusive) of CACM) and

(b) ensuring that once capacity is allocated, affected market participants should be compensated by the TSO (because of force majeure or an emergency situation invoked by the relevant TSO as provided for under Article 72 of CACM).

We note that the SEMC consultation paper also refers to alternative compensation rules to CACM within GB as developed independently by NGESO. It is unclear to SEMO if these proposals have legal status in GB and also if they have superseded the published ICZA ruleset previously endorsed by Ofgem and we would request the SEMC to clarify same ahead of a decision being made or as part of

[2] Capacity Allocation and Congestion Management (Commission Regulation (EU) 2015/1222, which is available here

[3] Commission Regulation (EU) 2016/1719 of 26 September 2016 establishing a guideline on forward capacity allocation, which is available here

its decision. In SEMO's view, the NGESO proposal as referred to in the SEMC consultation paper contradicts CACM[4] in particular regarding NGESO's compensation proposals for *uanallocated* day ahead and intraday capacity and also appears largely designed to address the process of explicit allocation and relevant compensation in the Channel region.

In the context of GB arrangements, SEMO also notes that the SEMC consultation paper states that "*The outcome of this consultation will exclusively apply to forward-looking arrangements in the SEM*". On this basis, we assume that any proposed arrangements arising from this specific consultation will only apply *within zone* to licenced SEM participants only.

As a consequence, SEMO is concerned that the adoption by the SEMC of any compensatory mechanisms, such as that proposed by NGESO, that is non-compliant with European legislation will generate a discriminatory regime within SEM post Go-Live of the Celtic Interconnector. The same compensation regime which is in line with applicable European legislation for ICOs operating on the SEM-GB and the SEM-FR and other borders should apply. We therefore urge legal clarification be provided on the status of any future compensation methodology in the context of the operation of the SEM post the Celtic Interconnector delivery.

In addition, SEMC should also note that where capacity has been curtailed by either a TSO, or an ICO, SEMO does not seek compensation for the lost revenue owing to lower volumes of traded energy for the affected period where capacity has been curtailed. This treatment by SEMO is in our view in line with the required compensation regime under the European legislation outlined above where compensation solely relates to recouping costs tied to already allocated capacity and not compensation for potential revenues related to unallocated capacity. Furthermore, in support of the validity and efficacy of CACM and FCA in managing compensatory claims at cross zonal interconnectors, SEMO could find no examples across Europe, either EU-EU or EU-GB, where an EU entity paid out compensation to an ICO in the event of curtailment of unallocated capacity.

While SEMO believes the adoption of an EU compliant methodology is required to ensure non-discrimination against market participants on different borders, it is clear in our view that a detailed SEM-specific assessment of how the obligations of CACM should apply during this interim period is also required. SEMO believes that similar aguments as those set out above should apply to any forwards arrangements. Those arrangements need to be compliant with the applicable EU legislation (including the FCA) to ensure within zone non-discriminatory rules for market participants who are the holders of Long Term Transmission Rights (LTTR) on the SEM-GB, SEM-FR and other borders in the future.

2. **This paper references various principles that underpin different approaches to compensation arrangements for NTC reduction (i.e. 'causer pays', 'cost neutrality', 'different compensation arrangements for allocated and unallocated capacity). In your view, what principles should underpin compensation arrangements for NTC reduction going forward in SEM?**

SEMO's opinion, as stated above, is that any such compensation arrangements that may be adopted must be in line with the existing European network codes and regulation. As summarised above, the

[4] See for example Articles 70 and 71 of CACM - available here

existing European legislative framework already expressly provides for clear lines of responsibility for compensation where both allocated and unallocated capacity are subject to curtailment. The development of SEM-specific methodologies compliant with the applicable EU legislative requirements will simplify the compensatory process for all market participants and ensure non-discriminatory treatment for all market participants.

3. **Are there any other factors, not covered in this paper, which should be considered by the RAs ahead of a decision? If providing, please explain relevance.**

In SEMO's view, one element not covered by the content of the SEMC consultation paper, which is related to the issues being consulted upon and which we believe should be considered by the SEMCahead of a decision being made, is the detail of how congestion income flows from the SEM-GB interconnectors should be allocated/distributed. At present, the SEM-GB ICOs are the sole party that receive all of this revenue stream. While acknowledging the obligation on the TSO to prepare its use of revenue statements in accordance with its TSO licence for approval by the relevant Regulatory Authority, SEMO is of the view that the SEMC should consider ahead of its decision on this consultation how congestion income from the SEM-GB interconnectors received by the ICOs should be allocated in accordance with the requirements of Regulation (EU) 2019/943[5] (the Electricity Regulation). In particular, Article 19 of the Electricity Regulation provides as follows:

> *2.The following objectives shall have priority with the respect to the allocation of any revenues resulting from the allocation of cross-zonal capacity:*
>
> *(a) guaranteeing the actual availability of the allocated capacity including firmness compensation; or*
>
> *(b) maintaining or increasing cross-zonal capacities through optimisation of the usage of existing interconnectors by means of coordinated remedial actions, where applicable, or covering costs resulting from network investments that are relevant to reduce interconnector congestion.*
>
> *3.Where the priority objectives set out in paragraph 2 have been adequately fulfilled, the revenues may be used as income to be taken into account by the regulatory authorities when approving the methodology for calculating network tariffs or fixing network tariffs, or both. The residual revenues shall be placed on a separate internal account line until such a time as it can be spent for the purposes set out in paragraph 2.*
>
> *4.The use of revenues in accordance with point (a) or (b) of paragraph 2 shall be subject to a methodology proposed by the transmission system operators after consulting regulatory authorities and relevant stakeholders and after approval by ACER. The transmission system operators shall submit the proposed methodology to ACER by 5 July 2020 and ACER shall decide on the proposed methodology within six months of receiving it.*

[5] Available here

ACER may request transmission system operators to amend or update the methodology referred to in the first subparagraph. ACER shall decide on the amended or updated methodology not later than six months after its submission.

The methodology shall set out at least the conditions under which the revenues can be used for the purposes referred to in paragraph 2, the conditions under which those revenues may be placed on a separate internal account line for future use for those purposes, and for how long those revenues may be placed on such an account line.

5.Transmission system operators shall clearly establish, in advance, how any congestion income will be used, and shall report to the regulatory authorities on the actual use of that income. By 1 March each year, the regulatory authorities shall inform ACER and shall publish a report setting out:

(a) the amount of revenue collected for the 12-month period ending on 31 December of the previous year;

(b) how that revenue was used pursuant to paragraph 2, including the specific projects the income has been used for, and the amount placed on a separate account line;

(c) the amount that was used when calculating network tariffs; and

(d) verification that the amount referred to in point (c) complies with this Regulation and the methodology developed pursuant to paragraphs 3 and 4.

Where some of the congestion revenues are used when calculating network tariffs, the report shall set out how the transmission system operators fulfilled the priority objectives set out in paragraph 2 where applicable."

From the above language in Article 19, it appears clear in SEMO's view that the allocation and use of congestion income needs to be approved by the Regulatory Authorities. Clarification around the allocation and use of this income by the ICOs is in SEMO's view needed going forward and should be considered by the SEMC ahead of their decision.

As mentioned above, at times of reduced capacity, the actions of a TSO or an ICO can lead to a loss of revenue for the market operator. Where this arises, there is an increase in market operation costs for SEMO but SEMO has no right under the current approved market arrangements to claim compensation. Under the provisions of Article 76 of CACM, in SEMO's view, recovery of loss of revenue by SEMO could be permitted and the TSO or ICO (as applicable) whose actions led to the increase in costs could therefore be liable to compensate SEMO for such costs. At present, this compensation is not sought by SEMO, but in SEMO's view, this is an area that needs to be clarified going forward.

Conclusion

SEMO believes that revised compensation arrangements within SEM can play a key role in ensuring an equitable and competitive marketplace for all participants, enabling the evolution of future electricity networks and interconnection that can deliver a low-carbon future, as envisaged in the Climate Action Plan. SEMO is committed to supporting the SEMC in ensuring that any compensatory arrangements are appropriate, non discriminatory and contribute appropriately to our low-carbon future. We look forward to continued collaborative engagement with the SEMC, the TSOs, the ICOs, and other key stakeholders to conclude the appropriate NTC compensation arrangements in the coming months.

Yours Sincerely

[sent by email and accordingly bears no signature]

Michael Kelly
Director of Market Operations, SEMO

cc. Stephen Clarkin