



**Market Power Mitigation in the SEM**  
**Market Monitor Identity – Decision Paper**

7<sup>th</sup> July 2006

AIP/SEM/82/06

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# 1 Introduction

On the 9<sup>th</sup> June 2006, the RA's published a consultation paper entitled "*Market Power Mitigation in the SEM: Market Monitor Identity*" [AIP/SEM/62/06]. The purpose of that paper was to identify the options available to the RAs in respect of candidates to undertake the role of the Market Monitor and to propose the RAs' preferred option. The purpose of this paper is to set out the comments received from interested parties, the RAs response to those comments and the final decision on the Market Monitor identity.

## 1.1 Executive Summary

Eight responses to the consultation paper were received. The majority of the comments focused on the following topics:

- Role of Market Monitor
- Independence
- Governance
- Experience and Resources

The RAs have reviewed the comments received and provided responses. The RAs agree that additional detail on the role of the Market Monitor and the interface with participants is necessary and will be provided in the next Market Monitoring consultation paper.

With respect to the independence of the Market Monitor, the RAs re-state their belief that the Market Monitor must be independent of all market participants. Affiliation between generation and the Market Monitor would undermine the SEM.

The issue of governance of the Market Monitor was raised by some participants. The RAs believe that it would be inappropriate for the Market Monitor to report primarily to the market participants. The RAs believe that participants will have an important role in working with the Market Monitor to ensure that the market works in an effective and competitive manner.

Participants raised queries with respect to the necessary skills, experience and resources available to the RAs to undertake Market Monitoring. The RAs agree that additional resources with specialist skills will be needed to carry out Market Monitoring.

Taking account of the options available, the criteria for selection and the comments received, the RAs propose to develop the Market Monitor within the regulatory offices.

## 2 Background

There were three options outlined in the consultation paper. The first was the stand alone entity. This effectively means the creation of another regulatory body, separate from the RAs. The role and functions of this new regulatory body would be set out in legislation. The Market Monitor would have a formal duty to report directly to the RAs. The second option explored was for the Single Market Operator or System Operators to fulfil this role. This option would entail the creation of a specific duty in the market operators or the system operator(s) license to perform the role of the Market Monitor. Under this option the Market Monitor would report directly to the RAs. Lastly the third option was for the RAs to undertake the role.

The RAs proposed the following criteria to evaluate the alternative options

- Feasibility
- Effectiveness
- Efficiency
- Programme
- Independence

Based on these criteria, the RAs proposed to undertake the Market Monitoring function.

### **3 Discussion of Issues Raised**

This section contains a discussion of the issues raised in the responses to the consultation. The issues are grouped under the following headings.

#### **Role of Market Monitor**

In general, market participants stated that more information was required about the role and responsibility of the Market Monitor as well as the interface arrangement with participants. The RAs agree that specific detail in this area is necessary and this will be the subject of a separate consultation.

#### **Governance**

Airtricity argues that the Market Monitor must be primarily responsible to the market participants. The RAs disagree. The governance of the Irish electricity market and indeed most European electricity markets provides for independent oversight of the market, by a regulatory authority specialising in such markets. Participants are subject to regulatory oversight. The trading mechanisms are developed by regulators in consultation with participants. There are few, if any, examples where market participants are the ultimate decision makers.

The RAs are not aware of any electricity market where the Market Monitor reports primarily to those that are being monitored. While it may be true that some market participants bear the consequences of market abuse, by definition, other market participants are carrying out the abuse. It would be inappropriate for the Market Monitor to report to participants on a market abuse, when one or more is believed to be guilty of that abuse. Ultimately it is the customer who will bear the consequence of market abuse, due to the undermining of market confidence. It is the RAs duty to protect the interests of the customer and regardless which entity undertakes that function, the RAs believe that it necessary for the RAs to give direction to the Market Monitor and for the Market Monitor to be responsible to the RAs.

The RAs believe that market participants have an important role to play in the monitoring of the market, having the experience that is only gained from operating in the market. It is intended to provide for processes by which the Market Monitor can obtain information

from participants, including any concerns that participants may have. Further, the RAs believe an important part of the Market Monitor's role will be to provide analysis on the state of the market to participants, potential participants and financial institutions. The details of how the Market Monitor interfaces with participants will be subject to a further consultation. However, the RAs see no reason why or practical way in which the Market Monitor would be directed by and responsible to participants.

## **Independence**

NIE argues that the level of independence of the Market Monitor is a criterion which needs to be balanced against other conflicting criteria such as feasibility. While the criteria for the Market Monitor has been laid out, it is conceptually possible that a plan could be so deficient in one criterion so as to make it a poor option no matter how well it performs on other criteria. That said, in this particular case the criterion of independence does not seem to require a compromise on any other criterion. For this reason, it is prudent to insist on independence from market participants.

NIE argues that the new single market operator is the natural agent to undertake the role of observing the market. There is a requirement under the EU Directive for the SOs to be independent.

ESBI makes a similar argument to NIE, in essence arguing that the Market Monitor should be undertaken by the SMO once the issues regarding its independence have been dealt with.

The Single Market Operator (SMO) will comprise EirGrid and SONI, the two system operators<sup>1</sup>. For the SEM to function correctly the SMO and both system operators have to operate independent of market participants and in accordance with the trading and settlement code and the grid code and the RAs have approved the proposed SMO arrangements as complying with this requirement.

The RAs believe that the Market Monitor role does not lend itself to being fully codified in a manual such as the trading and settlement code or the grid code. There will be

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<sup>1</sup> In the remainder of this paper the SMO refers to EirGrid and SONI acting jointly.

instances where the monitor is required to make professional judgment on issues that affect particular market participants. Therefore, the necessary level of independence is greater. If the SMO was to undertake this function, then analysis demonstrating abuse of the market by a participant could be undermined by allegations made by the offending participant. This would put the Market Monitor and the RAs in the position of first having to defend the independence of the Market Monitor before dealing with the abuse. The RAs believe this to be an undesirable outcome.

The RAs are not questioning the integrity of the future SMO. To the contrary, the SMO will be entrusted with operation of the market, management of the dispute resolution board under the trading and settlement code and recommending potential changes to the trading and settlement code. Clearly these roles require independence and the RAs have confidence in the SMO to perform this role independently.

Airtricity argue that RAs have an interest in the pool price as this has an impact on the retail prices which are approved by each regulator. While it is true that the RAs currently approve the retail prices, it is unclear why this would lead to bias. The RAs are charged with protecting the interests of the final customer. The RAs believe an effective and competitive electricity market is in the best interests of the final customer.

Airtricity further argue that the position of the Minister (in RoI) as shareholder/owner in the ESB and as co-regulator of the industry in conjunction with the CER entails a conflict of interest that is not present in GB, where OFGEM regulates non-State-owned entities. This argument implies that the Minister and the CER have a conflict of interest in the regulation of the market, the Minister as the majority shareholder of ESB and the CER as being an emanation of the State. The CER rejects this argument. State ownership of an asset in a competitive market is not uncommon in the European context and does not lead to bias by the State, whether by a Minister through a legislative process or by direction to the State's regulator. Further, EU Directives would mitigate any such bias, which does not in any case exist. Airtricity also fails to realise that the Market Monitor will report to two Regulatory Authorities jointly, both of which are concerned with the market. While it is true the RAs have many objectives, set by statute, it is difficult to see how allowing participants to game or abuse the market would be consistent with any regulatory objective.

Synergen argue that they would support the Market Monitor being carried out within the regulatory offices if it were to operate in the same manner as an independent entity, free from direct day to day control of the RAs. The objective is to have an open, impartial and transparent system of Market Monitoring. Synergen does not provide a strong rationale for why it is necessary to have the arms length arrangements between the Market Monitor and the RAs. The RAs do not intend to or see how it would be practical for the two RAs to direct day to day activities of the Market Monitor. The RAs would intend to ensure that the Market Monitor is staffed and funded, provided direction as to its remit and managed as to how well it is meeting its responsibilities.

Also while the Market Monitoring function is a key to detecting market abuse in the SEM, the formal enforcement of sanctions will still be a function of the RAs. Therefore if market participants truly have concerns, in Airtricity's case the independence of the CER and in Synergen's case the competing objectives of the RAs, regardless what findings the Market Monitor makes, it will ultimately be the RAs that will implement any corrective action. In the vast majority, the commentators concede that the RAs must have adjudicatory responsibility with respect to the Market Monitor's findings. They recognise that aside from courts of competent jurisdiction, only the RAs could actually sanction market participants. The issue that they raise seems to be that the RAs adjudicatory role will be compromised if staff of the RAs serves as the investigator or monitor. This is simply not the case. The RAs are fully capable of balancing arguments made by RA staff against arguments made by affected parties and reaching an objective, fact-based decision. The RAs do not agree that a Market Monitor that reports to the RAs in any way compromises the RAs quasi-judicial role. Further, the RAs believe that it is best qualified to ensure that the Market Monitor is properly charged and properly performs its functions.

### **Experience and Resources**

The SEM will present a new set of electricity trading arrangements on the island of Ireland. The means of regulating incumbents will change. The role envisaged for the Market Monitor in SEM has not being undertaken by any existing organisation in the current markets, either in Rol or NI. Airtricity raises the point that the RAs do not currently have the required expertise and experience to do so. The RAs agree. If the RAs are to carry out the Market Monitoring role then additional specialist resources will

be required. This is true for all options under consideration. The option to either directly contract with individuals or to hire a specialist firm to provide the analysis is ultimately for the entity undertaking role to decide.

## **Summary**

There was not clear preference by respondents as to the identity of the Market Monitor. Some respondents favoured the stand alone entity undertaking the role, others favoured the SMO and the remainder preferred the RAs undertaking the role either on a permanent basis or for an initial period.

The stand alone entity, as outlined in the consultation paper, establishes another regulatory body to undertake the role of the market monitor. Hence the need for legislation was outlined in the consultation paper and concerns were raised on timeframe and the increase in regulatory burden. The RAs believe the stand alone entity as assessed against the criteria is not the optimum solution.

The remaining two options are the SMO or the RAs to undertake the role. Both models have their merits. An SMO based Market Monitor would be close to the day to day operation of the market and operational staff of the system operators. An RA based Market Monitor would be close to the decision makers for enforcement and direction. However, the SMO model does not meet the independence criteria for the Market Monitor as set out by the RAs. The RAs do not rule out the possibility that after several years, with the role of the Market Monitor established, and both system operators have been vested to re-examine where the Market Monitor is placed.

## **4 Decision**

Taking account of the options available, the criteria for selection and the comments received, the RAs will develop the Market Monitor within the regulatory offices.

The next consultation on the Market Monitor will describe in detail the functions and responsibilities of the Market Monitor and the interface arrangements with participants.