



Memorandum of Understanding
between the
Government of the United Kingdom of Great
Britain and Northern Ireland
and the
Government of Ireland

*Presented to Parliament
by the Secretary of State for Foreign and Commonwealth Affairs
by Command of Her Majesty
December 2006*

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THE SINGLE ELECTRICITY MARKET (SEM) ARRANGEMENTS

Introduction

This Memorandum describes the arrangement between on the one hand the Government of the United Kingdom of Great Britain and Northern Ireland (“the UK Authorities”) and on the other the Government of Ireland (“the IRE Authorities”) in relation to the establishment and operation of a single wholesale electricity market in Northern Ireland and Ireland.

References in this Memorandum to the “SEM” are to new arrangements in both jurisdictions relating to the trading of wholesale electricity in Northern Ireland and Ireland, such arrangements being designed to promote the establishment and operation of a single competitive wholesale electricity market in Northern Ireland and Ireland and including all of the arrangements described or referred to in this Memorandum. The UK and IRE Authorities (together, “the Authorities”) will work together with a view to the enactment of legislation in both jurisdictions to enable implementation of the SEM on 1 November 2007, as planned.

References in this Memorandum to “the Regulators” are to the Northern Ireland Authority for Energy Regulation (“NIAER”) and the Commission for Energy Regulation (“CER”).

Policies of the Authorities and Regulators

In designing and implementing the SEM the Authorities are committed to the principle of co-operation in order to ensure to the fullest extent possible the effective, efficient and competitive functioning of the SEM. Legislation in both jurisdictions providing for the SEM will, in particular, confer on the Department of Enterprise, Trade and Investment, the Minister of Communications, Marine and Natural Resources and the Regulators specific functions and provide specific powers that are considered by the Authorities to be necessary or expedient to further the aims of the SEM.

The Authorities recognise that the systems for the regulation of the generation, transmission, distribution, wholesale trading and supply of electricity in Northern Ireland and Ireland and the functions of the Regulators within their respective jurisdictions differ. It is not the intention of those authorities to require harmonisation of all regulatory functions.

The Authorities will consult each other on electricity matters within their respective jurisdictions that materially affect or are likely to materially affect the SEM.

In order to facilitate the purposes of this Memorandum the Authorities will provide each other and intend that the Regulators provide each other and the Departments with as full and open access as is possible to all information necessary or expedient for furthering the purposes of this Memorandum, including scientific, technical and policy information and, where appropriate, representations which relate to the SEM. These exchanges may be subject to restrictions or requirements such as those relating to vital national interests, confidentiality, data protection or freedom of information requirements. The Authorities, in particular, accept that:

- (a) it is for the Authorities or Regulators providing the information to state what, if any, restriction there is to be on its usage; and
- (b) each Authority and Regulator will treat the information it receives in accordance with any such restriction.

The SEM

The Authorities intend that the SEM arrangements will be designed to promote the creation of a single competitive, sustainable and reliable market in wholesale electricity in Northern Ireland and Ireland within the context of the European Union's policy on the creation of an EU-wide internal market for electricity, while aiming to minimise the cost of establishing such a market.

In particular, the Authorities intend that the SEM arrangements will, among other things:

- (a) be transparent, integrated and promote competition in the sale and purchase of wholesale electricity on an all-island basis, and thereby enhance prospects for investment in the electricity sector in Northern Ireland and Ireland;
- (b) facilitate the participation of renewable energy generators in the market;
- (c) take into account the operation of arrangements in relation to the environment;
- (d) incorporate a harmonised approach to transmission connection policy and planning criteria for transmission networks and activities, and appropriate regulatory and contractual arrangements for the planning, development, operation and contractual access for connection to and use of the transmission systems in Northern Ireland and Ireland being undertaken on an appropriately co-ordinated all-island basis;
- (e) provide for the monitoring and regulation of the behaviour of market participants and may include the imposition of bidding principles and bidding rules;
- (f) incorporate a co-ordinated approach to address the issue of market power effectively in a transparent manner;
- (g) include appropriate regulatory and contractual mechanisms to enable the arrangements to develop over time, in line with the aims of the SEM;

- (h) promote, where possible, a harmonised approach on an all-island basis to security of supply issues; and
- (i) provide for a harmonised approach to the investigation of licence breaches including, where appropriate, provision for on-site investigations.

Organisation and Structure of the SEM

For the purpose of establishing and operating the SEM and as part of the SEM, the legislation will, among other things, provide for or make provision in connection with:

- (a) the introduction, in each jurisdiction, of new contractual arrangements for the trading of wholesale electricity within Northern Ireland and Ireland (“the new trading arrangements”) to supplement or replace the existing separate wholesale electricity trading arrangements in each jurisdiction. The new trading arrangements will include the introduction of a new all-island framework for the trading of wholesale electricity – the Trading and Settlement Code within a gross mandatory pool arrangement (subject to such exceptions as may be considered appropriate), which will be governed by a single law. In addition, other new contractual arrangements may be required to be entered into, for instance, arrangements to mitigate the risk of abuse of market power on the SEM, ensure system security or system stability etc. These arrangements will also include such transitional arrangements as are appropriate, including arrangements required to run-off existing arrangements;
- (b) changes to current transmission and distribution arrangements including, among other things, and where considered necessary or expedient: changes to current arrangements for scheduling and dispatch; system operation, planning and development; the introduction of agreements between transmission system operators as to the operation of their respective systems within an all-island context; changes to connection and use of system arrangements; and changes to distribution and grid codes.
- (c) the mandatory modification of existing licences in each jurisdiction, and the modification or replacement of existing orders providing exemption from any requirement to be licensed, in each case to the extent considered necessary or expedient to implement or facilitate the operation of the new SEM arrangements or in consequence thereof or to give full effect thereto;
- (d) the establishment of a market operator function through which the trading arrangements will be administered, and the creation of a new licensable activity of “acting as SEM operator” as defined for purposes of the legislation. The SEM operator will, among other things, provide

an appropriate structure for the delivery of efficient business functions for the market and the administration of day-to-day trading and the settlement and clearing process under the Trading and Settlement Code. Initially, it is intended that this function will be undertaken jointly by System Operator Northern Ireland Ltd (SONI) and EirGrid under appropriate contractual arrangements, with appropriate authorisations;

- (e) arrangements to ensure appropriate protection of information while permitting and facilitating the exchange of information needed to facilitate the operation and regulation of the SEM;
- (f) common duties in respect of the exercise of the Authorities' functions and the Regulators' functions in circumstances which may materially affect the SEM. These would include duties designed to promote co-ordinated regulation of the SEM;
- (g) provisions and arrangements necessary or expedient to address issues arising from implementation, or in consequence of, the introduction of the SEM including provisions designed to ensure that the ability of NIAER to direct the cancellation of existing cancellable generation unit agreements in Northern Ireland will not be prejudiced by the introduction of the SEM recognising that such contracts are likely to subsist following implementation of the new trading arrangements, subject to such amendments as may be considered necessary or expedient in connection with or in consequence of the implementation or operation of the SEM;
- (h) the imposition, if considered necessary or expedient, of licence conditions requiring licensees to conduct, or procure conduct of, specific activities or to apply for, or procure application for, particular licences; and
- (i) such other provisions and arrangements, including transitional provisions and arrangements, as may be considered necessary or expedient to facilitate the implementation or operation of the SEM or in consequence of such implementation.

It is recognised that the introduction of new arrangements and changes to existing arrangements as contemplated by this Memorandum may necessitate the termination or amendment of existing contractual arrangements or the entering into of such new arrangements.

Competition and Market Power

The paramount importance of ensuring that the SEM is as competitive as possible is recognised by both Authorities particularly with regard to market power. There are challenges to be addressed in both existing markets if the required outcomes in terms of competition, transparency and consumer choice are to be delivered. Competition needs to function effectively in order to ensure that the benefits of the increased scale of the single all-island market are to be passed through fairly to consumers.

The introduction of the SEM legislation will not of itself be capable of solving all the issues of market power. Regulatory action will need to be matched by policy measures in the electricity sectors in Northern Ireland and Ireland.

In the interests of promoting competition, it is intended that the SEM arrangements will include an appropriately defined set of transmission system operator activities in each jurisdiction (including appropriate contractual arrangements in relation to the conduct thereof), such activities and the activities of the SEM Operator to be carried out by one or more organisations that neither carry out the activity of generation or supply in Northern Ireland or Ireland nor, from such time as may be considered appropriate, have any affiliates that carry out the activity of generation or supply in Northern Ireland or Ireland. To that end, the SEM arrangements in Northern Ireland will include the transfer of such transmission system operator activities into a company which, at the time of transfer, conducts no electricity-related activities other than activities of transmission system operator and SEM Operator.

Regulatory arrangements intended to promote the mitigation of market power in the SEM are being developed by the Regulators, and arrangements in that regard are intrinsic to the SEM.

SEM Committees of NIAER and CER

The legislation will establish special committees of NIAER and CER (“SEM Committees”) to take decisions on their behalf as to the exercise of their respective functions in respect of the SEM. The legislation shall make such other provision as the Authorities consider expedient or necessary in connection with the performance by the SEM Committees of their functions.

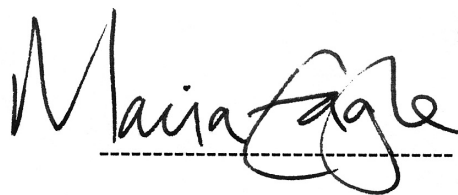
The legislation will provide for the appointment, removal and remuneration, where relevant, of SEM Committee members. Each SEM Committee will comprise up to seven persons, made up of no more than three members from among the members and staff of NIAER, no more than three from the Commissioners of CER and one member independent of NIAER and CER. The members may be appointed (and may be removed) by the Authorities. The Authorities will have power to

appoint a deputy to the Independent Member. The legislation will also provide for the quorum and voting for meetings of the SEM Committees.

The legislation will provide for the establishment of joint working arrangements between NIAER, CER and the SEM Committees to ensure co-ordinated and orderly regulation. The Authorities will work together to ensure that the SEM is implemented in a co-ordinated fashion.

It is recognised that the SEM will develop over time through the exercise of regulatory functions. In addition, it is recognised that the actions of the Authorities over time may impact on the SEM. The Authorities are committed to a policy of ongoing co-operation in respect of the SEM and will consult with each other before acting in a manner which may materially affect the SEM.

The foregoing record represents the understandings reached between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Ireland upon matters referred to therein. This Memorandum of Understanding is not legally binding on the Authorities.

Handwritten signature of Maria Eagle in black ink, written over a dashed horizontal line.Handwritten signature of Dermot Ahern in black ink, written over a dashed horizontal line.

Signed on behalf of the Government of the United Kingdom of Great Britain and Northern Ireland by the Parliamentary Under Secretary of State, Northern Ireland Office.

Signed on behalf of the Government of Ireland by the Minister for Foreign Affairs.

Date: 6 December 2006

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ISBN 0-10-170022-9



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