Scope of CPM medium Term review – consultation paper

Moyle Interconnector Ltd response

16th June 2009

Moyle welcomes the review being carried out by the regulatory authorities and proposes that the following issues relating to treatment of interconnectors are considered in detail in the review:

1. The CPM should encourage availability of capacity. The mechanism fails to achieve this objective for interconnector users. Interconnector users are only paid a capacity payment for power which flows into SEM. Users are only motivated to buy interconnector capacity and make commercial offers if they can reasonably be expected to be taken in the unconstrained schedule. At present Moyle capacity is sold in minimum durations of monthly blocks so because a user happens to have capacity the SEM may receive bids when the user does not reasonably expect to be taken. However Moyle is intending to sell its capcity on a much more granular basis with the effect that an interconnector user's objective will only be to take capacity and make commercial bids when they can expect to be taken in the unconstrained schedule. The CPM does not encourage Moyle users to offer capacity to the market when that capacity is not likely to be taken in the unconstrained schedule even if such an offer would be very viable in the constrained schedule.
   Post gate closure there is no incentive via the CPM for interconnector owners to make unused capacity available to the market. Other incentives exist via separate arrangements with the TSO's but CPM does not affect these.

2. The CPM should be predictable. Again the CPM fails to achieve this objective regarding interconnector users. The ex-post element of the capacity payment is unpredictable for interconnector users because their CPM payments are related to flows and not availability and flows are related to the ability to predict prices in two markets. The unpredictable CPM revenue will be discounted in interconnector users bids to SEM and consequently a higher arbitrage would be required between the Betta and SEM markets for trade to take place. Indeed applying the ex-post element to interconnector users provides zero incentive for them to increase availability and in effect raises SEM prices because it prevents trades at times of narrow arbitrage. Making the ex-post element predictable for interconnector users would provide the same interconnector availability but would increase trade and so lower SEM prices.

3. CPM should be fair. Moyle has maintained since the CPM was designed that it is unfair to the interconnector supply chain. The total availability of an interconnector is considered when calculating the required capacity in the CPM. Yet capacity payments are only made to the interconnector supply chain based on flows. Consequently generators receive windfall gains based on how much the interconnector flow is less than its availability. The interconnector supply chain does provide capacity to the market, at least to the level of a generator exposed to mechanical and electrical failure. An interconnector can start faster, ramp faster and react faster than most generators. The CPM treatment of interconnector is

also unfair to the market and customers. The market rules prevent interconnector users providing power after gate closure. In many instances interconnector users could provide lower cost power to meet the unconstrained schedule than the next generators in the bid stack.

4. Moyle would not encourage the linking of Capacity payments to ancillary service provision. We believe this should be arranged separately with an interconnector owner and not via the capacity payments to an interconnector user.

5. Previously we have proposed to the regulatory authorities a change to the market rules to allow interconnector users the ability to provide a post gate closure price to the market. Based on this price the TSO's could then dispatch interconnector users within day (up to two hours ahead of real time) to minimise the cost of constraints. In order to incentivise interconnector users to provide a within day price they would be rewarded with a capacity payment for their offers for unused capacity. There is a risk that interconnector users would submit an extremely high price to avoid being taken in the constrained schedule. To avoid this scenario we proposed that the capacity payments be reduced based on how much the offered price exceeded SMP. Indeed such a mechanism should be considered for generators also to avoid old inefficient and poor performing generators being connected to the system to collect the capacity payment with little intention of running.
   We are still minded that our proposal is worthwhile and would urge the regulatory authorities to consider it in detail. The detail has been sent to the RA's previously but can be provided again on request.
   a. Our proposal would allow interconnector users unused capacity (based on the unconstrained schedule) to be used for the constrained schedule. The table in Appendix A provides an analysis of how often this might occur. Essentially for 15% of the periods analysed there were on average 88MW of interconnector bids within 5% of the SMP price. We would assume that these would all be within market for the constrained schedule. The prices used are based on the interconnector user bids – it should be noted that the within day bids (those used for the constrained schedule) are likely to be higher as interconnector users have to cover the risk of them being taken and the Betta price moving since they submitted the bid. However it should also be noted that interconnector users currently only bid to be taken in the unconstrained schedule. When this is not likely they will avoid taking interconnector capacity and avoid bidding into the market. Indeed during the period analysed there were significant periods when Moyle had unallocated capacity. Under the scenario envisaged in our proposal this capacity would have been taken and bid into the market. The bids would probably not have been taken for the unconstrained schedule but may have been useful in the constrained schedule.
   b. We recommend that further studies be carried out to determine the potential value of allowing interconnector users to provide within day bids. In Appendix B we have considered just one arbitrary day where we identified periods in which there were unused interconnector offers which were lower cost generator offers taken in the constrained schedule i.e. Interconnector offers that could have been used for constraint management. Notwithstanding, inter alia, our assumption that

Interconnector user's within day price would be the same as their gate closure price, our analysis suggests that the constrained schedule could have cost c.£8k less (c.£3m per annum scaled pro rate) by allowing interconnector users into the bid stack for the constrained schedule.

c. There is concern that there would be a major and unpredictable difference between Day D Betta prices on Day D-1 compared to Day D prices on Day D such that interconnector user within day bids would have to be very high (and worthless to the SEM) to cover their risk.

   An analysis is provided in Appendix C generated by simply comparing Day D price with the previous similar type day's price. Even with this extremely crude approach to bidding, a 20-30% uplift on D-1 price would cover the majority of the time a user could be called on (bearing in mind that the interconnector user would be paid additional capacity payments). In reality a bidding strategy would be much more refined by using market data relating to the next day which should be factored into the Betta price for Day D on Day D-1 rather than our analysis which merely uses the Day D-1 price compared to Day D price. Additionally some interconnector users may be hedged through the Betta market and would therefore not only face the risk as a potential loss and not an actual loss.

   It is our confirmed understanding that interconnector risk premiums to cover within day Betta price movements would mean that generally interconnector within day bid prices would still be competitive with SEM standby generation, used in the constrained schedule but not in the unconstrained schedule. It is however accepted that at times of low plant margins in the Betta market it is likely that the interconnector within day bid price may not be competitive.

   To provide further comfort to the RA's that a useful within day price would be provided, the interconnector users risk that Betta prices would be unacceptably higher than their bids could be limited. This could be achieved by allowing interconnector users to fail to supply (similar to a generator trip on start up). However in this circumstance to provide an incentive to supply an interconnector user would have to suffer a penalty if they failed to supply (eg one month's worth of capacity payments for unused capacity or similar).

We strongly recommend that the RA's consider our proposal as part of the scope of the CPM review and the other work stream reviewing the treatment of interconnectors in the SEM. We will feed our comments here into the other work stream also.

6. Generally there is no market mechanism currently that rewards interconnectors for the benefits they bring to the market. Certainly while a strong arbitrage is available between the two connected markets and competition exists to profit from the arbitrage then the interconnectors should earn a contribution towards their capital and operating costs. However if limited arbitrage exists then the interconnectors will earn very little (or nothing based on EU congestion management principles) towards their costs. Effectively this is a market signal to exit. Of course this is the wrong market signal as an interconnector's capacity contribution is very valuable to a market – provided that the full supply chain is in place to provide power if it is called to do so.

Paying capacity payments into the supply chain, rather than to an interconnector owner, means that such payments are at risk and are not easily bankable by the interconnector owner – thereby avoiding a rush to build "unnecessary" interconnectors.

This CPM review is a good opportunity to ensure that the SEM provides the proper economic signals to interconnector owners, developers and users. We urge the RA's to make most use of the opportunity.

Please do not hesitate to contact me (paddy.larkin@moyleinterconnector.com) if you have any queries related to this submission or wish to discuss further.

Appendix A

Analysis of interconnector user offers into SEM
24 Feb 2008 to 3 Jan 2009
Offers higher than SMP
(i.e. Not dispatched and potentiallly available for constraint management)

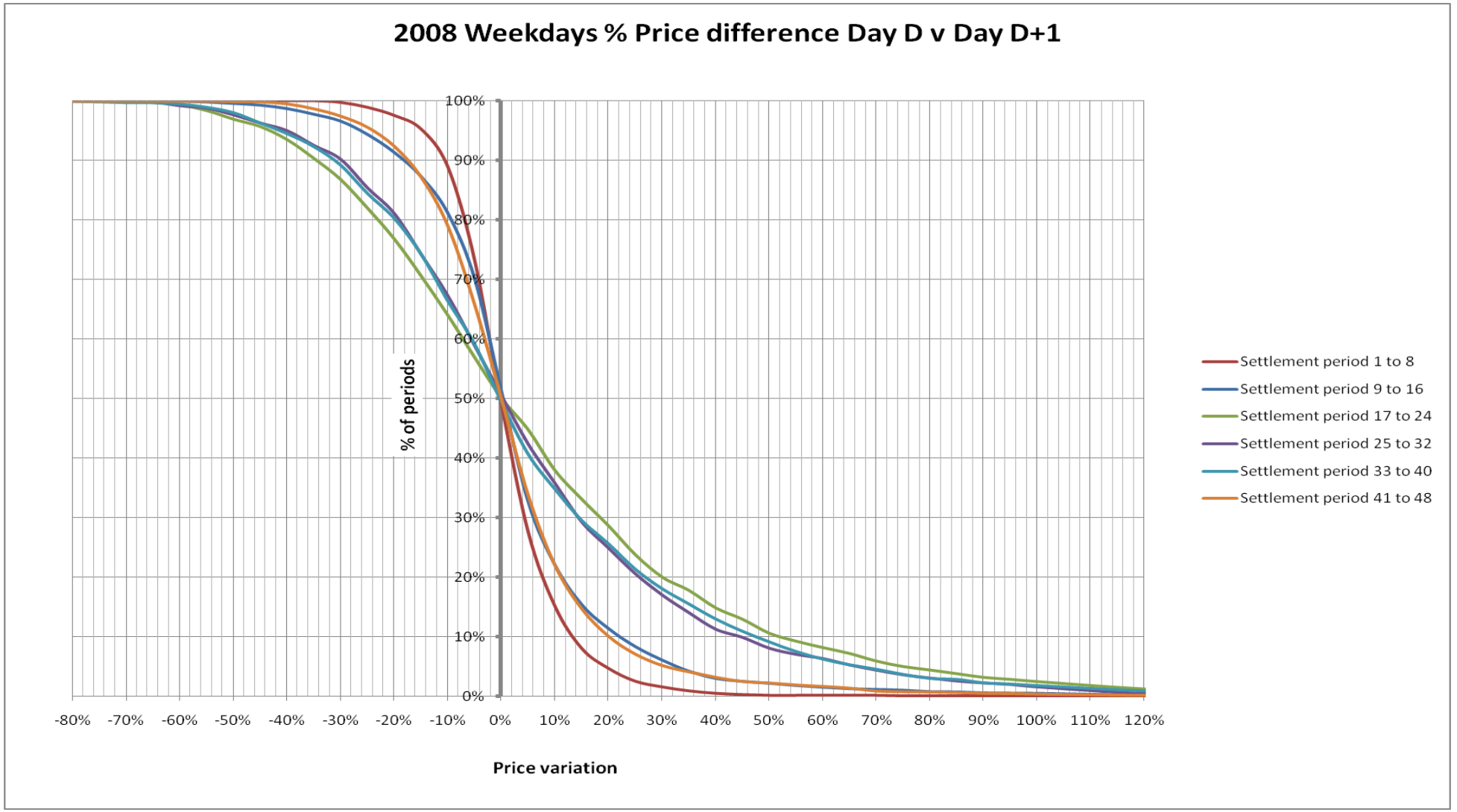
Period start		24/02/2008	02/03/2008	06/04/2008	04/05/2008	01/06/2008	06/07/2008	03/08/2008	07/09/2008	05/10/2008	02/11/2008	07/12/2008	
Period end		01/03/2008	05/04/2008	03/05/2008	31/05/2008	05/07/2008	02/08/2008	06/09/2008	04/10/2008	01/11/2008	06/12/2008	03/01/2009	**Averages**
Number of half-hours in period		336	1680	1344	1344	1680	1344	1680	1344	1344	1680	1344	
Number of periods with IC bids within	20.00% of SMP	132	55	69	239	822	611	851	359	363	732	591	
% of periods analysed with IC bids within	20.00% of SMP	39.29%	3.27%	5.13%	17.78%	48.93%	45.46%	50.65%	26.71%	27.01%	43.57%	43.97%	**41.1%**
Total quantity (MW) associated with bids within	20.00% of SMP	3369	4303	3282	24152	102753	79462	113313	41612	22063	52776	57745	
Average quantity (MW) associated with bids within	20.00% of SMP	26	78	48	101	125	130	133	116	61	72	98	**105**
Number of periods with IC bids within	15.00% of SMP	98	28	40	202	645	490	688	280	283	593	534	
% of periods analysed with IC bids within	15.00% of SMP	29.17%	1.67%	2.98%	15.03%	38.39%	36.46%	40.95%	20.83%	21.06%	35.30%	39.73%	**33.7%**
Total quantity (MW) associated with bids within	15.00% of SMP	2450	2444	1125	19655	76847	60046	82956	30373	16963	42643	49150	
Average quantity (MW) associated with bids within	15.00% of SMP	25	87	28	97	119	123	121	108	60	72	92	**99**
Number of periods with IC bids within	10.00% of SMP	61	15	33	140	461	304	526	194	186	446	433	
% of periods analysed with IC bids within	10.00% of SMP	18.15%	0.89%	2.46%	10.42%	27.44%	22.62%	31.31%	14.43%	13.84%	26.55%	32.22%	**24.9%**
Total quantity (MW) associated with bids within	10.00% of SMP	1525	1165	783	13476	49019	34917	58337	19472	11210	30036	38780	
Average quantity (MW) associated with bids within	10.00% of SMP	25	78	24	96	106	115	111	100	60	67	90	**92**
Number of periods with IC bids within	5.00% of SMP	27	12	18	52	262	169	310	75	101	268	267	
% of periods analysed with IC bids within	5.00% of SMP	8.04%	0.71%	1.34%	3.87%	15.60%	12.57%	18.45%	5.58%	7.51%	15.95%	19.87%	**14.8%**
Total quantity (MW) associated with bids within	5.00% of SMP	675	833	387	4697	24431	18335	34214	7738	5990	17880	22725	
Average quantity (MW) associated with bids within	5.00% of SMP	25	69	21	90	93	108	110	103	59	67	85	**88**

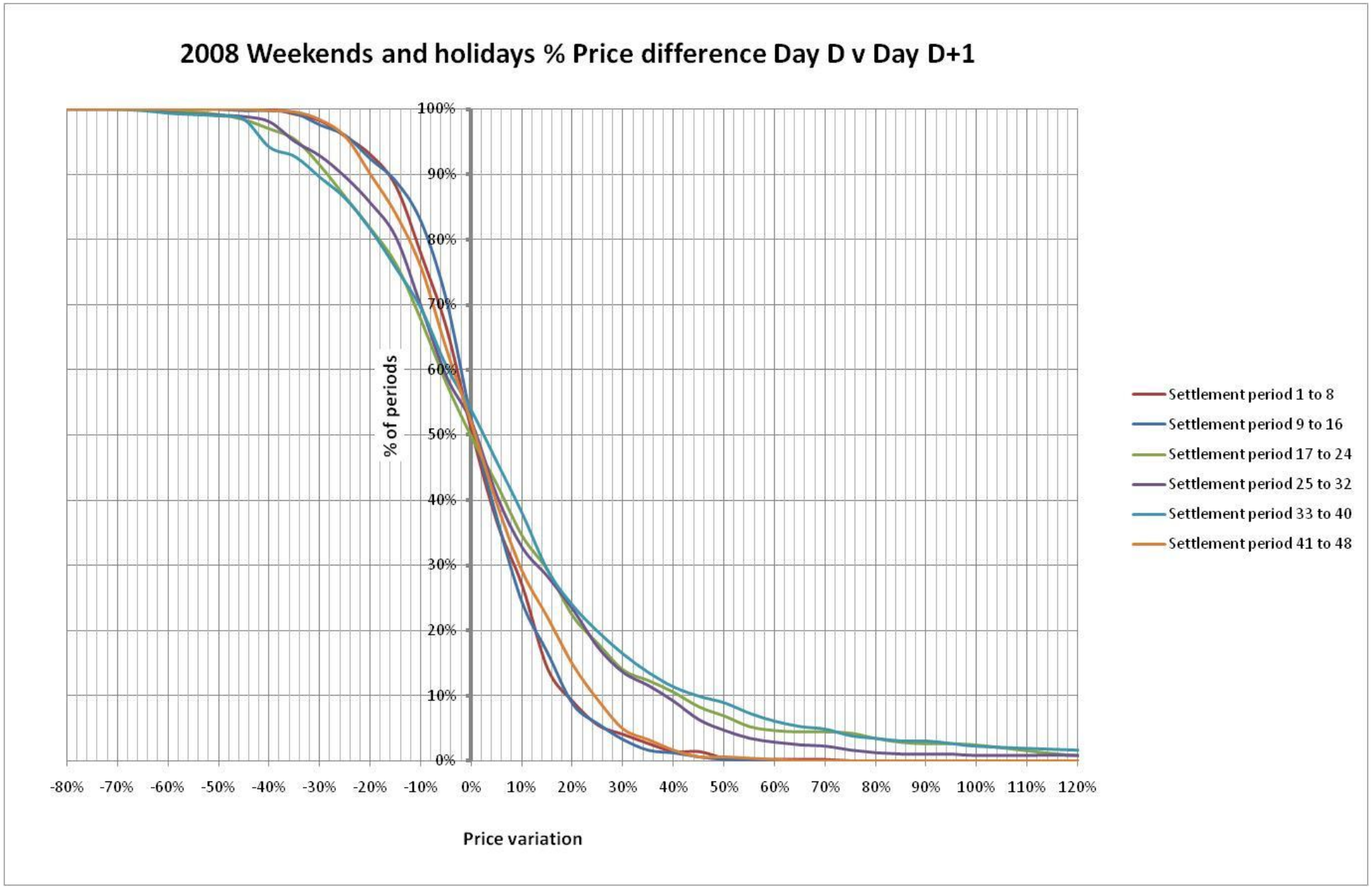
Appendix B

Summary
Analysis of IC bids potentially available for constraint management
Delivery date - 13 December 2008

Periods where untaken IC offer is < Generator offer taken in constrained schedule:		
Average generator offer price taken in constrained schedule		£67.6
Average interconnector offer price (not taken)		£59.0
Average difference between untaken IC offer and taken generator offer in constrained schedule	(a)	£8.7
Dispatch quantities that could have been met by using IC offers in constrained schedule	(b)	1,840MW
Potential saving from using IC offers in constrained schedule	(a) * (b) * 0.5	£7,950

Appendix C - Analysis of price variation between Day D and Day D+1 prices




2008 Weekends and holidays % Price difference Day D v Day D+1
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
% of periods
-80% -70% -60% -50% -40% -30% -20% -10% 0% 10% 20% 30% 40% 50% 60% 70% 80% 90% 100% 110% 120%
Price variation
Settlement period 1 to 8
Settlement period 9 to 16
Settlement period 17 to 24
Settlement period 25 to 32
Settlement period 33 to 40
Settlement period 41 to 48