NIE Energy Limited
Power Procurement Business (PPB)

Principles of Dispatch and the Design of the Market Schedule in the T&SC

SEMC Proposed Position Paper

SEM-10-060

Response by NIE Energy (PPB)

12 November 2010.

Introduction

NIE Energy – Power Procurement Business ("PPB") welcomes the opportunity to respond to the SEM Committee's ("SEMC") proposed position paper on the Principles of Dispatch and the Design of the Market Schedule in the Trading and Settlement Code.

PPB also endorses the response provided separately by the NEAI.

General Comments

In our response to the 2009 consultation, PPB stressed the need for a comprehensive review of the market design, in the context of accommodating ambitious renewable generation targets. We welcome the SEMC's recognition of the need to consider scheduling and dispatch issues in a "holistic" manner, yet are concerned that there is little evidence that the SEMC has actually adopted such an approach. This is evident from the conflicting messages between this consultation which is concerned about avoiding creating a gap between the market and dispatch schedules, whereas the SEMC decision on TLAFs is proposing to significantly expand that gap.

We agree that the market design should not frustrate the realisation of renewable targets. However, the design must also ensure that conventional generation, which will be needed to support the inherent volatility of wind generation, is adequately remunerated otherwise there will be a major risk to security of supply for consumers in Ireland.

From a strategic perspective, the sustainability of the SEM in the medium to longer term must also be questioned in the context of an increasing impetus for regional markets and not least to facilitate increased levels of renewable generation through exports. Early consideration and indication of the strategic development options and direction is needed to ensure the orderly transition or evolution of the market.

It is also clear (and expressed at the October forum) that engagement with the financial markets is particularly difficult for both conventional and renewable generators at present and adding to regulatory uncertainty and further risk will make financing and hence delivery against the investment goals, even more difficult.

Specific Comments

Comments on Issue 1 – Principle Underlying Construction of the Market Schedule

We have a number of concerns with the proposals presented in relation to the alignment of the Market Schedule (MS) and actual Dispatch.

Our first major concern relates to the conflicting SEMC position between proposals here that indicate the SEMC will intervene where the two schedules diverge, yet the proposals in respect of TLAFs are to actively seek to create divergence between the MS and actual dispatch. Such conflicting positions can only increase the perception of regulatory risk to the financial markets in the relation to investment Ireland.

In relation to the SEMC position outlined in the consultation paper, our major concern relates to the threat and regulatory risk attaching to intervention by the RAs in the operation of the market. For example, it is not at all clear what will be defined as "material harm" or how it will be objectively determined. The RAs propose to publish a framework later this year but it is difficult to see how the perception of increased regulatory risk will be removed.

It is also not clear that increasing constraint costs (e.g. relative to energy costs) is necessarily a problem and indeed it may highlight that network investment is not being managed effectively by the System Operators and in such circumstances the remedy is to ensure the SOs operate effectively and efficiently, rather than to seek to revise the design of the market without actually addressing the underlying problem.

Comments on Issue 2 – Allocation of Infra Marginal Rents behind Constraints

It is concerning that the SEMC seems to select Option 1 as its preferred approach to address the allocation of IMRs should a problem arise at some point in future. This leaves a great deal of uncertainty for existing generators and for potential investors that will not be in the long term interests of customers. It is not clear why the SEMC finds this option persuasive, given it had little support in responses to the previous consultation and indeed the paper clearly recognises that existing generators will face increased risk from new entry by more efficient but non-firm generators who will themselves be similarly exposed to that risk from further entry.

It was very clear from both the presentations at the Forum on 12 October and from all the comments from the floor (from both conventional and renewable generators), that the risk of removal of financially firm rights will have a material effect on existing generators (e.g. potential breach of financial covenants, ability to refinance, etc.) and potential new entrants who will either face an increased cost of capital or find that their planned projects are unable to secure financing. Such an outcome will increase costs to consumers, will endanger security of supply and will ensure renewable generation targets are incapable of being met.

We also disagree with the SEMC's view that Option 1 will incentivise the timing of new entry to be coincident with or following network delivery. It is claimed that this option reduces the burden on consumers and while this may be so, it merely redistributes that burden to generators, and while that may be considered to benefit consumers in the short term, it will ultimately be to their long term disbenefit, particularly where existing generators have virtually no scope to manage or mitigate the risk of its firm access rights being expropriated.

The removal of financial rights would expose existing generators to the network development efficiency of the TSOs (or asset owners if not the TSO). It is also unclear how "export constraints" will be ring-fenced from more general transient transmission limitations and therefore there is a risk that transitory restrictions and as a consequence, more general decision making by the TSOs, could impact on the profitability and financial returns for generators who currently hold firm access rights. This exposure to TSO decisions on the precise level of the export constraint at any instance will require a significant increase in the information required by all generators (and suppliers) to understand and be able to model the operation of such a market, and to validate the TSO decision making and analysis in respect of the precise level of constraint.

Finally, the legality of the removal of firm access rights is also questionable.

Comments on Issue 3 – Least Cost Dispatch

We agree with the proposals but again reiterate the need for transparency in relation to the dispatch decisions of the TSOs which, for marginal generators, are virtually impossible to understand and impossible to model in any meaningful way. We also refer back to our previous comments on this matter that do not appear to have been considered, in relation to removing the option to register as a "Price Taking Unit" from most generating units, thereby requiring the majority of generators to submit prices that would facilitate economically efficient curtailment by the TSOs should such a requirement arise.

Comments on Issue 4 – Priority Dispatch

We recognise that the matter of priority dispatch is primarily a legal one, particularly in the context of the 2009 RES Directive. We concur that those generators afforded priority dispatch under mandatory EU requirements should have priority over those generators provided priority dispatch by the exercise of discretion by a Member State.

However there is a tangible difference between priority dispatch and priority scheduling, the latter effectively being how priority dispatch has been facilitated in SEM. This is particularly relevant in relation to Peat which is afforded discretionary priority dispatch by the RoI legislation. Peat does not require priority in the market schedule, but as it is fully dispatchable, it could receive priority when it is actually dispatched. As we have noted in previous consultation responses, this is a discretionary decision of the RoI government and hence should not be supported by Northern Ireland consumers who have different obligations imposed under various UK arrangements, and hence the constraint costs for peat fired plants should be ring-fenced and fully recovered from RoI customers.

We continue to believe that notwithstanding that renewable generators will be afforded priority dispatch, there will be occasions when (for example for network security or other reasons) the full output cannot be accommodated and for which economic factors should be used to dispatch generation at the least cost, thereby minimising costs to consumers.

Comments on Issue 5 – Hybrid Plant and Priority Dispatch

PPB agrees with the approach proposed.

Comments on Issue 6 – Deemed Firm Access

PPB agrees with the approach proposed.

Comments on Issue 7 – Treatment of Variable Price Takers in the Market Schedule

PPB agrees with the approach proposed while again referring back to our previous view that the majority of generators should be registered (and participate) as price making units.

Comments on Issue 8 – Grid Code Matters and Information on Technical Issues

PPB agrees with the approach proposed but also highlight our earlier comments that any erosion of financial firmness for generators would undoubtedly require much more information to be made available and expose the TSO decision making to extensive real-time scrutiny.

Comments on Issue 9 – Tie Breaks

The implementation of pro-rated curtailment of wind generators appears impractical and it is not clear how this would be carried out in real-time. For example if there were 10% too much wind generation at some point that needed to be curtailed, are the TSOs planning to reduce the output of <u>all</u> wind generators by 10%? We believe it would be much more sensible for the generators to have provided prices that would allow a merit order to exist and hence allow market forces to identify the order of curtailment.

Comments on Issue 10 – Determination of SMP when Demand is met by Price Takers

PPB accepts the approach proposed, while again referring back to our previous view that the majority of generators should be registered (and participate) as price making units.

Comments on Issue 11– Demand Target and EEGs

PPB accepts the approach proposed, while again referring back to our previous view that the majority of generators should be registered and participate as price making units.