Consultation on the Principles of Dispatch and the Design of the Market Schedule in the Trading and Settlement Code

SEM/10/060

Viridian Power & Energy Response

12 November 2010

Endorsement of NEAI Position

Viridian Power and Energy (VPE) is aware of the response submitted to this consultation by the National Electricity Association of Ireland (NEAI). VPE has contributed to that response which contains the unanimous views of NEAI members (attached below) and VPE fully endorses it.

NEAI response to scheduling and dispat

In particular, VPE would like to draw attention to the following key points:

- There is a clear need for greater transparency and industry involvement in SEM market development.
- Any changes to SEM design or operation should be part of a holistic, clear, consistent and consultative direction.
- It is imperative to respect firm financial access rights and Option 1 to disregard such rights in the context of including constraints in the market schedule would certainly lead to financial default for some existing generators and will have a detrimental impact on the bankabilty of all future generation projects (thermal and renewable) which will be required for ensuring security of supply and achieving the 2020 renewable targets.
- Implementing Option 1 would also raise the cost of capital and make the SEM a less attractive place to invest and this increased risk would ultimately translate into an increase in the cost of electricity for customers. It would also result in the inefficient allocation of risks and could undermine CfD liquidity, again to the detriment of customers.
- Moreover, Option 1 would be very difficult to implement in practice and would because of its commercial consequences warrant a high degree of transparency and auditability of transmission system operator (TSO) decision making and processes[1].
- The arguments for Option 1 are not well founded and rather than promote efficient competition, which current market arrangements already facilitate, this option creates perverse incentives by potentially encouraging new generation where it is not needed.

[1] For the avoidance of doubt, addressing the practical issues would not address the principle objections to Option 1.

- To proceed with Option 1 subject to a 'material level of harm test' is highly inadvisable for the above reasons. Instead the focus should be on delivery of grid infrastructure and more engagement with industry.
- The timely delivery of grid infrastructure is a key pre-requisite to reducing constraint costs and to promoting competition and entry of new more efficient generation. More needs to be done in this regard, including the design and implementation of appropriate incentives for the TSOs that rewards early delivery of infrastructure to accommodate new generation and that disincentivises late delivery relative to defined connection dates.
- Signalling that Option 1 might be implemented depending upon the outcome of a 'material level of harm test' is extremely unhelpful from a financing perspective regardless of how remote the outcome is or what other considerations, such as proportionality, need to be taken into account.

Additional VPE comments

Clearly VPE is opposed to Option 1 that disregards access arrangements for reasons explained above and more fully in the NEAI response. The remainder of VPE's response provides comments additional to those made by NEAI, concentrating upon:

- ❖ Consistency of regulatory approach
- ❖ Material level of harm test
- ❖ Excessive generation events

Consistency of regulatory approach

The NEAI response supported the need for a holistic approach to market reform and suggested some sensible practical measures that would help achieve this, including the consistent application of principles and objectives across workstreams and in decision making. Building upon this point, it is worth noting that the position paper (notably the potential preference for Option 1 to disregard access arrangements and include constraints in the market schedule) permeates around the principle that plant available in dispatch should be able to access the market schedule, and the infra marginal rents (IMRs) that are associated with it. We consider that the underlying principle would thus be that the schedule and dispatch would be broadly aligned, and as the regulatory authorities (RAs) note, the schedule is the reward route for IMRs. In this context there is a need for the RAs to re-evaluate the consistency and appropriateness of market splitting in TLAFs – where the opposite outcome would be delivered. For plant where the dispatch quantity exceeds scheduled quantity as a

consequence of the splitting of TLAFs (i.e. where actual TLAFs are better than schedule TLAFs) plant will be have MWs constrained on and thus paid at bid. These MWs will thus not be allocated IMR. The converse applies for plant where schedule TLAFs are worse than actual dispatch TLAF values – such plant is constrained off but retains its IMR. This outcome seems both perverse in terms of rewarding efficiency, contrary to the principles espoused in the current position paper and serves to undermine the reward system that underpins the SEM. This inconsistency of thinking by the SEMC only serves to add emphasis to regulatory risk in the eyes of the financial community.

Material level of harm test

Picking up on the NEAI response that strongly cautioned against applying a 'material level of harm test' (MLHT) VPE would like to emphasise its opposition to such a concept on the following grounds:

i) MLHT criteria will be difficult to define, and, in any event, may not be the relevant, necessary or appropriate indicators to prompt future action – for example it was suggested by the RAs at the workshop on 12th October 2010 that the ratio of constraint costs to energy payments might be one useful indicator but this will naturally increase with the lag in grid infrastructure exerting upward pressure on constraint costs and the increased penetration of renewaables exerting downward pressure on energy payments.

ii) The concept of a MLHT is alarming to investors and lenders and will thus increase the cost of capital and will make financing of future investments much more difficult (especially when Option 1 to disregard firm financial access arrangements has been signalled the preferred option).

iii) MLHT is not needed because the RAs can address any issues on a timely basis through the normal consultative process which sets out the issues in each case and if there is justification for change. There is however scope to enhance this process through more engagement with industry as outlined in the NEAI response.

iv) MLHT may be a blunt instrument that could trigger market change inappropriately, such as where a temporarily high level of constraints arises where the solution may lie in delivery of infrastructure, which could rectify itself after a short delay.

In addition to these points we would ask the following questions:

1. Will the SEMC be compelled to do something, such as implement its preferred Option 1, in the event that the 'material harm' threshold is breached?
2. What if this happens in advance of a known transmission upgrade (such as the North-South interconnector) that is likely to reduce the materiality of the problem beneath the threshold in a couple of years?
3. If the SEMC is not compelled to act, pending future developments (such as delivery of major transmission upgrade projects, regional integration or market coupling) what is the point in formally having a MTLH test?

Given the above, VPE would strongly urge the SEMC to reconsider the merits of a MLHT.

Excessive generation events

VPE agrees with the SEMC's proposal that in the event of excessive generation events (EGEs) arising from an excess of price taking generation, the quantity of generation charged PFLOOR should not exceed system demand. However it is very concerning that PFLOOR will continue to be used in EGEs when this is a negative value (minus €100 to date). As highlighted at the Eirgrid Customer Conference on 3rd November 2010 the SEM has already experienced negative pricing because of an EGE. Even if it does not become a dominant price setting condition it has very serious financing implications once it enters the consciousness of the financing community[2]. The price applicable in EGEs therefore needs to be zero, achievable by setting PFLOOR to €0.

[2] We know from experience that the mere possibility of these events was an impediment to securing financing for windfarm projects. Now that an EGE has actually happened this will be all the more problematic.