

**NIE Energy Limited
Power Procurement Business (PPB)**

**Incentivising of All-Island Dispatch
Balancing Costs**

Consultation Paper

SEM-11-048

Response by NIE Energy (PPB)

29 July 2011.



Introduction

NIE Energy – Power Procurement Business (“PPB”) welcomes the opportunity to respond to the consultation paper which seeks views on the Incentivisation of All-island Dispatch Balancing Costs.

General Comments

PPB is generally supportive of incentive arrangements, providing they are meaningful and are targeted at controllable costs. PPB has some concerns in relation to the proposed incentives for the TSOs to manage Dispatch Balancing Costs (DBC). (We also note that the TSOs already have licence obligations requiring dispatch in accordance with a merit order and it would therefore imply that if potential savings are available then the TSOs would technically be in breach of their current licences were they not to capture those savings)

Firstly, any such incentive arrangement must be carefully considered both to ensure they are focused on costs that the TSOs can control and that there are no unintended consequences from such incentives.

Secondly, it is already difficult to penetrate and understand the TSOs’ decision making in relation to dispatch where the obligations on the TSOs are to operate a merit order dispatch and maintain operational security of supply. Unless the incentive arrangements are carefully drawn up, the overlay of commercial incentives could create conflicts and could have unintended consequences. For example, if the TSOs were to prioritise DBC because of a potential incentive gain, that could result in greater risk to security of supply and perhaps increased customer disconnections. It is also possible that there may be occasions where minimising DBC could be in breach of the TSOs’ licence obligation to operate merit order dispatch.

We have a particular concern relating to outage planning and would be very concerned if decisions relating to generator outage requests were primarily taken by the TSOs with DBC incentives in mind. Similarly, it could create tension between decisions relating to transmission outages required to connect new generators or customers and DBC cost management and decisions could, for example, be skewed to focus on DBC because of the incentive rewards to the detriment of progressing customer connections. Such scope for conflict must be properly considered and addressed in any incentive arrangement to ensure the anticipated outcomes reflect and meet the wider objectives of the market.

We note the references to the balancing incentive mechanism in BETTA. However, the GB market is very different to the SEM given that generators in BETTA self-dispatch and hence, for example, NGT does not have any licence obligations relating to merit order dispatch. NGT are also active traders in the GB market which we do

not consider is appropriate for the TSOs in SEM who are responsible for independently scheduling all the other generators in the market. Hence the context of the incentive arrangements on NGT is very different to those that would be appropriate in SEM.

Specific Comments

Wind and Demand forecasting accuracy

We agree that the accuracy of wind and demand forecasting is something over which the TSOs have autonomy and therefore could be appropriately incentivised. It is also worth noting that the benefits of improvements in such forecasts should also improve the indicative running schedules provided to generators and reducing variability of such forecasts should, for gas fired generators, reduce their risks in gas procurement, and any such reduction would naturally flow through into prices for customers.

Incentive Design

As we have already noted, the design of any DBC would need to be carefully considered to ensure that they are clearly areas where the TSOs have scope to influence the costs but which do not result in unintended consequences for other market participants and customers. A key issue that is required in the market, regardless of whether DBC incentivisation is progressed, is transparency around the TSO decision making so that market participants can be confident of the criteria being applied by the TSOs and can make informed judgements as they model the market for internal business planning purposes, investment decision making, etc.

While the use of dead-bands or other features could be implemented to cushion the TSOs from deviations caused by factors outside their control, analysis would be required to evaluate the potential variation that could occur, otherwise the size of the dead-band may be inappropriate. Failure to properly calibrate such an arrangement could either result in windfall gains to the TSOs with corresponding losses to customers or should it turn out the other way, the incentive on the TSOs to mitigate potential losses could result in extreme decision making by the TSOs to try to overcome their risks such that it could detrimentally affect other market participants and security of supply for customers.

It will also be very difficult for the RAs to monitor and oversee the TSOs actions and where there are allowances for exceptional circumstances, the regulatory oversight that is required could become unwieldy unless the criteria is simple. We consider there to be a significant risk that the day to day regulatory input required to determine which events and costs are allowable could expand considerably. Again the detailed design is critical if a manageable and transparent regime is to be created.

Conclusions

While recognising the potential benefits of creating an incentive for the TSOs to manage DBC, the design of the scheme needs to be carefully thought through to ensure both that there are no unintended consequences and that sufficient transparency is created around the TSO decision making such that other market participants and the RAs can clearly understand the decisions and actions of the TSOs.

There are clearly some easier metrics that could be established, for example, in relation to wind and demand forecasting, for which external influences are limited. Similarly, features of the GB arrangements in relation to operation of the transmission network could also be adopted. However, we believe considerably more work is needed to design and develop workable incentives in the area of generator dispatch. Such design should include full consultation with other market participants.

It is not clear if the need for further work would enable implementation of DBC incentive arrangements from October 2011. However, it may be worthwhile phasing in the arrangements and those elements over which the TSOs have full control could be adopted initially while design and shadow running of longer term DBC incentives could operate in parallel. We would also suggest that ancillary services should also be considered in any incentive arrangement .