

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

**Proposals for Implementation of the
European Target Model for the
Single Electricity Market**

Consultation Paper

SEM-12-004

Response by Power NI Energy (PPB)

20 April 2012.



Introduction

Power NI Energy – Power Procurement Business (“PPB”) welcomes the opportunity to respond to the consultation paper on the proposals for implementation of the European Target Model for the Single Electricity Market.

We recognise that this is a difficult and complicated matter to address and we appreciate the work concluded to date by the RAs, SEMO and the TSOs in developing the thinking underpinning the consultation paper and in facilitating and participating in the various workshops and meetings that have occurred to assist participants in developing a better understanding of the proposals.

PPB is also actively involved in the NEAI and in the IBEC-CBI Joint Business Council Energy Stakeholder Working Group and fully endorses the comments made in the responses from both these organisations.

High level review of the proposed options

The proposals don’t consider the commercial risks

Following a detailed review and consideration of the options proposed in the consultation paper and from information obtained in the subsequent discussions with the RAs, SEMO and the TSOs, it is evident that the proposals have been developed very much from a process and system perspective with little consideration of the commercial risks the options create for market participants. The proposals are largely “pathways”, as described in the SEMO/TSO paper, which, for the evolutionary options, outline the potential for different market structures in each of the trading horizons to interact with the adjacent market windows while retaining core elements of the SEM. The consideration does not however then extend to evaluation of the commercial implications of such arrangements for participants seeking to operate and manage risks in the market. For example, under the voluntary pool in option 2, there is significant scope for price volatility depending on the level of generator and supplier participation which would require some additional facility in the arrangements (e.g. the ability to bid price caps for demand and price floors for generation) to enable participants to manage and mitigate such risks. Therefore as each of these new commercial risks are considered, there is a high risk of generating lots of “fixes” to overcome various issues that overall, results in significant, and inefficient change.

There are many matters outstanding

It is also clear that there are many fundamental issues that are outstanding, including how capacity payments are incorporated, how losses will be dealt with, what would represent compliance, etc. Resolution of some of these issues may take some time (e.g. losses, Network Code sign-off) and could impact on the final market arrangements.

Options that limit trading to interconnectors are discriminatory

We consider that the options that seek to limit trading opportunities in various trading windows to interconnectors is discriminatory and that all market participants should have the same opportunities to manage risks across the different trading horizons.

The Central Dispatch debate is diversionary

The debate over central versus Self-dispatch is also, we believe, diversionary. The Europe wide Day-ahead and Intraday trading arrangements will result in firm physical commitments and therefore these have to be accommodated. The issue is then really around the compensation arrangements that are required to enable the TSOs to dispatch such generators away from their market position in the circumstances when the “market” and the real world need to disconnect. We recognise that the Irish market is small and has specific operational issues. However as in all systems, the TSOs will always have the final say in physical dispatch. The issue is therefore really over the compensation arrangements needed to facilitate differences between participants’ market and physical positions.

All the options represent significant change

It is consequently evident that there is no simple “tweak” to SEM that would facilitate compliance in a sustainable and non-discriminatory manner and all of the options represent significant change.

Observations on the Market Design options

Need for unambiguous terminology

It also became clear in the various exchanges that there is a need for clear and unambiguous use of defined terms as there is the scope for significant confusion when terms are interpreted or understood differently. One particularly confusing term is that of “retaining SEM” since there is no common understanding of what “SEM” means in this context (e.g. is it a wholesale pool or is it the ABB market clearing engine) and therefore it adds confusion to the debate rather than aiding focus on what are the fundamental issues that need to be considered in relation to Bilateral markets versus a Pool market, etc.

Option 4 looks difficult and would it be compliant?

It is unclear how Option 4 could operate to remove the volume risk it would create for participants and it is equally unclear if the option would be compliant with the EU Target Model.

There is a risk of inconsistent pricing in Options 1-3

Options 1-3 appear to create the scope for inconsistent prices across the different trading opportunities and it is unclear for example if the forward market is priced on the basis of shadow prices, whether the Day-Ahead coupling and Intra-Day trading is based on a shadow or some “all-in” price, and how each of these prices relate to the Balancing prices. To the extent the prices are not on the same basis then this is likely to encourage or lead to inefficient trading which conflicts with the general EU objective.

Market Power & Liquidity will need to be addressed regardless of the option

Market Power and liquidity is likely to be a concern regardless of the structure and design of the market and hence mitigation measures will be required for any of the market solutions.

Legislative Changes are inevitable and should not constrain the design

It seems likely that some legislative changes will be required and hence any need for such changes should not constrain the identification of the most appropriate market that delivers a sustainable market for customers and participants alike. This could also impinge on the renewable market and hence could require a reassessment of the renewable support mechanisms rather than constraining the market design to accommodate specific requirements.

Moving towards compliance with the Target Model

The current consultation and the various helpful engagements with the project team to discuss the proposals have highlighted that there is no simple solution to allow compliance with minor modifications to the existing market. Given that the solution seems likely to be more radical than we had initially hoped, we believe it would now be prudent to actually take a step back and to re-evaluate the High Level Design Principles, particularly as there have been significant developments since they were developed in 2005 and to, in particular, consider what is most appropriate for the All-Ireland market as we look forward in relation to such matters as bilateral vs pool for the forward market, the most appropriate form of balancing arrangements for Ireland, etc.

Such reflection would ensure that decisions on the detailed design are based on re-validated high level design principles and would help ensure the changes implemented to ensure compliance with the Target Model also ensure the market is sustainable and is fit for purpose for stakeholders in Ireland.

Key Design Principles

While we have no fixed views at this stage on the relative merits of a bilateral market compared to a pool market or on the structure of the balancing arrangements, there are a number of key principles that we believe must be inherent in any market reform.

- The market must be non-discriminatory and local market participants should be able to trade between each other on the same basis as applies through the Day-Ahead and Intra-Day coupling arrangements, such that there is consistency in the market.
- Capacity payments must remain.
- Firm Ex-Ante market positions must be respected and constraint payments made where the TSOs dispatch generators differently.
- Participants must be capable of managing price and volume risks in a consistent and coherent manner across the different trading windows.
- The market design must be resilient to further change after 2016.

Conclusions

It is clear, having considered the consultation paper and been involved in a number of discussions with the project team, that there is no simple evolutionary solution that would enable compliance with the Target Model through a few minor changes to the existing market.

The market coupling requirements means the design principles must be modified and therefore we consider that it would be appropriate to re-affirm and update where necessary the High Level Design principles that should underpin the market going forward, such that it is sustainable for customers and participants and can effectively couple with neighbouring jurisdictions, in compliance with the EU requirements.

Such a review would establish the framework for the detailed consideration of the design of a sustainable market that meets the needs of consumers and participants in Ireland. As we noted earlier, a lot of the work to date has concentrated on the functional processes with little consideration of the commercial implications. This requires a wider perspective and it may now be appropriate to secure objective external assistance to help identify the most suitable options.