

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

**Implementation of the European Target
Model for the SEM Capacity Costs**

Next Steps Proposed Decision Paper

SEM-12-105a

Response by Power NI Energy (PPB)

21 December 2012.



Introduction

Power NI Energy – Power Procurement Business (“PPB”) welcomes the opportunity to respond to the consultation on the SEM Committee’s (SEMC) next steps proposed decision paper relating to the Implementation of the European Target Model for the Single Electricity Market.

PPB has particular concerns in relation to failure of the governance proposals to identify a formal forum for engagement with the market participants who will be most affected by revisions to the wholesale market (i.e. generators and suppliers). We comment on such “strategic” matters in the following section.

Strategic Comments

The proposed Governance and Project Arrangements

PPB’s most significant concern relates to the fact that while significant attention seems to have been applied by the SEMC to the proposals for governance and management of the project, the proposals make no reference to any forum for engagement with generators and suppliers who will be the market participants most affected by revisions to the wholesale market.

This is a very concerning gap and while the RAs indicated at the Information Session on 27 November 2012 that they, of course, expect to interact with such participants, the fact this critical stakeholder group is not explicitly addressed in the SEMC proposals gives a sense of the SEMC’s apparent views on the relative importance of generators and suppliers in the process.

This perception of disdain for the industry is supported by the evidence of recent interactions between the RAs and generator and supplier participants. The initial consultation on Implementing the European Electricity Target Model in the SEM¹ clearly took no account of the commercial issues that will arise from modification of the market to ensure EU Target Model compliance. Instead the initial proposals were developed bilaterally between the RAs and the TSOs/SEMO and as a consequence the options were skewed towards facilitation of the operation of the market from a technical perspective and took virtually no cognisance of the commercial viability of the proposals which must be a key consideration for a sustainable market.

On top of this failing, and following a consensus of strong objection from market participants to the proposals and the process from which they were derived, there has been a further 7 months of hiatus with virtually no engagement with generators/suppliers but again, as is evident from this consultation, continued interaction with the TSOs on the issue of self/central dispatch, which is clearly also a topic of interest to generators, and which we understood was a topic that was to be consulted upon further as a concept and not as a proposed decision to adopt central dispatch as a working assumption.

¹ SEM-12-04

Considering these together, it appears that the SEMC are unwilling to treat generators and suppliers commensurate with other market participants and stakeholders and we consider this is an unworkable approach that can only serve to lead to the development of a market that is unsustainable and, in the longer term, detrimental to the interests of consumers. If the revised wholesale market is to be competitive and effective, it must work commercially for generators and suppliers and therefore their wholehearted inclusion within the process to develop the market can only assist the exploration and investigation of market options and the ultimate development of a commercially viable and liquid market that enables participants to manage their risks.

The working assumption to adopt “Central Dispatch”

As we have noted above, PPB is concerned at the process that has resulted in the decision to adopt Central Dispatch as a working assumption. However it is not clear precisely what this means or to what extent it overlaps with scheduling/commitment and in our view is a decision that is unnecessary (and perhaps even divisive) at this time.

PPB has no particular preference at this stage, although we consider that it will always be the case that the TSO will always have rights to instruct levels of generation from any site to ensure the safe operation of the system. However, our concern over adopting such a working assumption is that it could constrain consideration of the full spectrum of market design options at this early stage which could result in a less effective/efficient market design than would otherwise be the case. Alternatively it could result in time being wasted developing a solution that is ultimately found to be unworkable because of this early constraint. Our experience is that the elements of market design are inter-related and hence a principle of “nothing is confirmed until all is confirmed” would appear to be a more sensible approach such that all aspects of the market design can be considered and assessed with an open mind.

At this stage we are unsure how the target model requirements for firm Day-Ahead market coupling and continuous Intra-day trading (which will result in firm commitments from generators and suppliers) would, for example, be reconciled with a pool market and until such matters are fully considered, we do not consider it is possible or sensible to constrain the thinking that will be required. We also note the TSOs indication that, while preferring central dispatch, they can work with central or self dispatch (although again the boundaries between dispatch and scheduling/commitment are unclear), and this supports the position of avoiding placing unnecessary bounds on what market design will give the most efficient outcome for generators, suppliers and customers.

Specific Comments on the proposed decisions

The High Level Objectives and Assessment Framework

PPB's response to the previous consultation called for a re-affirmation of the appropriateness of the high level principles for the market and therefore we welcome the assessment and agree with the SEMC's proposals.

Bearing in mind the decision in relation to Central Dispatch, it is worth noting the confirmation provided at the Information Session² that there is already a hybrid arrangement in the SEM since both renewable generators and interconnector units are effectively self scheduling/committing and dispatching. This preferential position for these market participants is at odds with the high level principles of Competition, Efficiency and Equity and therefore the SEM is non-compliant with the principles. Such discrimination must not permeate into the revised market design and a critical objective must be to ensure all participants have equal opportunity to manage its risks and operate in the market on a level playing field.

Implementing the European Target Model

PPB notes that the revised market must provide for the five pillars of the target Model as set out in ACER's Framework Guidelines. PPB welcomes the SEMC commitment to minimise changes to the SEM until 2016 and consider this will help minimise the competition for resources given that the project to implement the Target Model will inevitably be complex and resource intensive for all stakeholders.

PPB also welcomes the commitment to conduct impact assessments and a cost benefit analysis, although we are confused as to what circumstances would be inappropriate. PPB believes such assessments should apply in all circumstances and in relation to the Cost Benefit Analysis, comparison on competing compliant options must fully take into account all additional costs that may be incurred by market participants.

Options for a re-designed SEM

PPB welcomes the decision not to pursue the evolutionary options previously proposed and as we have previously highlighted, a critical reason for their impracticality is that they were developed in isolation and took no account of the commercial considerations that would have been identified had generators and suppliers been involved in the process.

The role of Ofgem in the re-design of the wholesale market in Ireland is unclear. We consider this should be limited to the efficiency of the interface with GB and market coupling and should not extend to the wider design of the wholesale market.

PPB also agrees with the comment that market power mitigation measures will continue although clearly their design will depend on the form of the market that is finally adopted.

² held on 27 November 2012

Central Dispatch

Our concerns and objections with the proposed decision on Central Dispatch are set out in the previous section.

Renewables

We note the SEMC decision that the revised market should seek to “promote” renewables “where appropriate”. It is not clear what this means in practice and we presume it does not mean providing any form of financial assistance through the market which is the role of the renewable support schemes in Northern Ireland and in RoI.

Capacity Payments

PPB strongly supports the continued inclusion of a capacity payments mechanism in any market re-design. We welcome the SEMC recognition of the importance that the total remuneration from energy payments, capacity payments and ancillary services is sufficient to provide a reasonable rate of return which will remunerate existing and future investments, thereby helping to ensure security of supply for customers.

PPB considers that this focus on “total remuneration” will be critical as we consider the market design, particularly given the ambitious renewable targets proposed for NI and RoI. The consequence of high levels of renewable generation on energy payments will need to be carefully assessed to ensure conventional generation is adequately remunerated since otherwise security of supply will be compromised.

We note the comment that any CPM will need to comply with relevant EU rules, although there are many arguments to explain why the adoption of a CPM in a small market, that is not part of a meshed grid and which has only finite interconnection to the GB market, would result in a lower cost of capital and hence cost for consumers than would be the case if investors were exposed to a more volatile energy only market structure and where their investment and risk management opportunities are constrained by the peripheral location of their investment. The CPM is therefore much more critical in the Irish market to attract and adequately remunerate investment and secure security of supply for consumers at a reasonable cost.

Governance and Project Arrangements

We have highlighted in our strategic comments section our concerns over the failure to provide for an explicit forum for engagement with the industry. We do however welcome the governance proposals that have been proposed, although also noting our desire for clarity over Ofgem’s role. In particular we welcome the proposal for a Stakeholder Forum to address general EU developments and to discuss the development of the Network Codes. We had called on the TSOs to progress such a forum over a year ago and are glad to see the value of it now being recognised (albeit belatedly).