Consultation Paper on Treatment of Gas Transportation Capacity Costs

Aughinish Alumina Ltd Response to SEM_12_089
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Introduction

Aughinish welcomes the opportunity to respond to this consultation paper and the discussion on whether gas transportation capacity costs should be reflected in price bids. It is Aughinish Alumina's view that gas transportation capacity costs should be included in price bids for all generators in the SEM and that a constrained version of Method 3 should apply. This view is subject to the SEM integration as part of the EU Market Integration Target Electricity Model and should be reviewed to reflect the proposed position in 2016.

Aughinish have no objection to this paper being published.

Detailed Response

All Island Market

As an initial point we are surprised that the decision appears to have already been made to disallow gas capacity costs in price bids for generators in Northern Ireland1. If a change to offers is permitted for generators in the Republic of Ireland only, this could result in a significant distortion in the SEM and could undermine the stated benefits of a gross pool. This imbalanced position would unduly disadvantage generators in the Republic of Ireland and would act to severely undermine the integrity of the market. The SEM is a single electricity market and this distortion could be used as a lever for further material market changes, e.g. dual zone pricing. Whilst substantial uncertainties already exist in the long term market structure due to Market Integration, this distortion would be a self-made Regulatory problem which could undermine investor confidence.

It may be that this inclusion of capacity costs in the bids of generators from the Republic of Ireland might act as a counter balance to the Carbon Price Floor (CPF) applying to generators in Northern Ireland from April 2013. If this counter balance is the driving force for this proposal then we would advise caution, due to the unintended consequences of other T&SC modifications (e.g. Dual Rated Generator Units). There are many potential solutions for dealing with distortions caused by the CPF, which though more difficult to implement, are more likely to achieve the desired aims.

[1] P7 "It is proposed that, irrespective of whatever costs are permitted within the Commercial Offers of units based in RoI, no allowance should be permitted within Commercial Offers for units based in Northern Ireland."

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Capacity booking strategy

As an initial point, we maintain that for a dual fuelled gas generator the level and durations of its gas capacity bookings must be entirely its own commercial decision. Back up fuel requirements mean that security of supply and hence eligibility for capacity payments are not at risk. For Regulators to prescribe an "optimum" strategy for gas capacity booking would be undue interference in the market and would inhibit innovation. Therefore a dual fuelled gas generator should be free to purchase no annual gas capacity, 100% annual gas capacity or any other percentage in the range, and will take the commercial consequences of its decisions.

Sufficient development in the trading of gas transportation capacity

To a certain extend the debate around whether there has been "sufficient development" of gas transportation capacity markets to allow costs to be included in the bids is unnecessary. It may be helpful to consider the principle of whether gas transportation capacity costs do indeed appear to be simple components of Short Run Marginal Cost. If so the Bidding Code of Practice BCoP could be clarified to deal specifically with this issue, without prejudice to the other established precedents and policies. This would negate the requirement to interpret the (BCoP), SEM Committee discretion within BCoP and previous regulatory statements2. Whilst regulatory certainty regarding the BCoP, and minimising changes to it, are desirable, there have already been a significant number of policy decisions with regard to BCoP and at least one significant policy reversal (Carbon Revenue Levy).

Calculating Marginal Costs of Gas Transportation Capacity

Consider the case of a dual fuelled gas generator which has purchased no annual or monthly gas capacity. In this case marginal cost could be based on the lesser of its;

- back up fuel cost, or
- the sum of daily gas capacity costs and daily gas purchase cost.

If the latter case applied, it could be argued that the sum of gas capacity and gas purchase costs represent major components of Short Run Marginal Cost (€/MWh basis) as envisaged under BCoP. In structure this would be very similar to the case of a generator in the North incurring both gas purchase costs and Climate Change Levy (under CPF) as major components of its true Short Run Marginal Cost.

However, the generator could calculate an alternative contribution to Short Run Marginal Cost of gas capacity cost by estimating its monthly aggregate MSQ and dividing the marginal monthly gas transportation capacity cost by this amount. If the daily equivalent sum were less than the daily capacity costs then it would seem sensible to allow the benefit of this lower marginal amount to be offered to the market.

[2] P3 *"Without the ability to buy or sell gas transportation capacity for a trading day, as is the case currently in Ireland, payments for capacity on gas transportation networks are best understood as (semi) fixed costs. This means that, to meet license conditions applying both in Northern Ireland and the Republic of Ireland, such costs should not be reflected in price bids, submitted to the Market Operator. This means that the fixed costs of gas transportation would be recovered through either the CPM or the energy market through infra-marginal rents or both.*
The Regulatory Authorities are conscious that the trading of gas capacity is currently undergoing change, not least due to EC Directive compliance. As gas transportation capacity markets develop, costs which are currently incurred on an annual or monthly basis may become

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Extending the above logic, the generator could also consider the costs of annual capacity booking versus annual estimated MSQ, again endeavouring to minimise its effective marginal gas capacity costs overall. It could be argued that this logic is similar to that in converting O&M costs, which may in practise be fixed annual sums, into €/MWh equivalents.

On this logic if daily gas transportation capacity costs are to be allowed in offers then they would act only as a cap on the component of cost offered, not necessarily the actual amount offered by each generator. Generators would in this structure be free to offer lower costs for gas capacity if this could be justified (e.g .based on reasonable pre-estimates of MSQ and actual capacity costs over longer periods such as a month or year). For generators with near 100% annual capacity bookings, the general expectation could be of a gas capacity cost component related to €/MWh capacity costs at 100% load factor. On this basis the reasoning for excluding gas transportation capacity costs for generators in Northern Ireland (i.e. 12 day ahead booking period for daily capacity) would not be valid.

It could be argued that the above level of flexibility in establishing the components of gas capacity transportation costs to be offered would place a significant burden on the MMU, essentially as envisaged under Method 3. However significant flexibility already exists in some material BCoP cost components, e.g. start-up costs. In addition, the consultation paper suggests that even under Method 2 three different gas capacity cost calculations (regulated and secondary, with actual or floor price) may run in parallel for different types of generators, which introduces the same potential complexity and judgement for the MMU.

On this basis we would ask the RAs consider Method 3 or a constrained variation of it, the most appropriate method of accounting for the cost of short term gas transportation capacity

<u>Opportunity Costs</u>

The case is made for using the price of secondary capacity in certain circumstances. The implication is that this could be priced based on non-firm, price regulated, secondary capacity (i.e. priced at floor price). We do not believe that use of a non-firm capacity product is an appropriate benchmark for inclusion in commercial offers, as once made generators' commercial offers are firm. Any price for secondary capacity must be based on a suitable, firm capacity product available to the buyer. If no price for this product can be established then the regulated capacity product is the better alternative benchmark.

<u>Capacity Payments Mechanism</u>

As stated in the consultation paper the Best New Entrant, BNE plant for 2013-15 is distillate fired. On this basis we can see no justification for recalculating the BNE price as short term gas transportation costs are included in offers.

Thank you on behalf of Aughinish Alumina Ltd for the opportunity to respond to this consultation,

Thomas O'Sullivan