Response to:

SEM-14-022 SEM Committee Consultation Paper: Determination of Uplift Parameters

6 May 2014

Part One: Introduction

ESB Generation & Wholesale Markets (ESB GWM) welcomes the opportunity to respond to this consultation. It is ESB GWM's strong view that the proposed changes to the uplift parameters should not be made. A summary of ESB GWM's comments are given in the points below. These are discussed further in Part Two of this response.

- **Scope of Analysis:** The four month analysis that underpins the recommendation is not robust and importantly does not take into account the growing impact of intermittent renewable generation on the level of starts in the SEM and hence the impact on uplift. This issue will only increase overtime and give additional cause to revert to potentially the existing values, thus creating uncertainty in the market.
- **Impact on Volatility & Contracting:** ESB GWM analysis shows that a significant negative impact on SMP volatility in the future should the new uplift parameters be introduced. Any possible benefit to consumers in terms of reduced SMP, might not be realisable as market participants must price this volatility into contracts. Furthermore a significant portion of contracting for 2015 has already taken place.
- **Impact on Generators:** The consultation has ignored the negative impact of the change in uplift parameters to generators. Many CCGT are fully dependent on uplift revenues as without this they earn no margin. ESB GWM analysis has shown a decrease in spark spreads of 11% should the new parameters be introduced. There is also a negative impact of renewable revenues, and hence the PSO will have to increase.
- **Regulatory Risk:** Uplift as a percentage of SMP has grown significantly since the beginning of the SEM. It was not envisaged that such "tweaks" by the SEM Committee (SEMC) to uplift parameters could have such a substantial impact on generator profitability. At a time when the market is facing into a period of significant change as a result of the ISEM project, it is important that there are no further regulatory risks. Furthermore, it is unclear given our analysis whether the objective of the SEMC, to reduce costs to customers, will be achieved using a technical lever rather than allowing the market to operate.

Part Two: Detailed Comments

2.1 Scope of Analysis

ESB GWM considers that the analysis of four months of data from 2013 is not robust enough to base the decision to change the uplift parameters.

Since 2011 uplift as a percentage of SMP has increased from 19% to 30%. This is due to low demand and high wind causing CCGT's to two-shift increasing start costs in the market. As the volume of wind generation grows, it is likely that this trend in uplift will continue.

It is important therefore that any analysis should take account of this trend and any policy should be forward looking and sustainable. ESB GWM strongly recommends that scenario analysis is carried out with high wind output. For example the first quarter of 2014 could be used.

2.2 Impact on Volatility & Contracting

Modelling analysis carried out by ESB GWM for 2015 using the proposed uplift parameters shows a larger impact on SMP than in the SEMC 2013 analysis. ESB GWM found that SMP would decrease by 2% on average, but with the most significant decrease of 3% in the summer months.

ESB GWM analysis also found a more substantial negative impact on SMP volatility compared with the results presented in the consultation. For 2015, ESB GWM found that the correlation between SMP and Shadow price fell to 0.52, which is significantly lower to the correlation figures presented for the four months analysed in the consultation paper. ESB GWM analysis also found that standard deviation of SMPs also increased with the new parameters by approximately 8%.

An increase in SMP volatility will mean that market participants will require a risk premium to be added when contracting. This could result in any potential benefit to consumers, in terms of the pass through of reduced SMP, not being realised. Furthermore many participants will already have put in place contracts for 2015 for a portion of their volumes, thus exposing them to contracting risk and losses through a technical and regulated parameter that was not effectively flagged in advance. The prices will have been determined based on an assumption of a continuation of the existing uplift parameters. Although there are some customers on a direct pass through tariff, overall they are a small portion of the customer base. If SMP volatility increases, the number of such customers may reduce in any case creating increased risk for generators and suppliers overall.

2.3 Impact on Generators

ESB GWM believes that the consultation paper has insufficient evidence of the impact of the proposed changes to uplift parameters on generators. The provision of evidence and the resulting confidence in the expected outcomes and assessment of any consequential impacts that may be unintended are an important regulatory attribute. ESB GWM analysis has found however that the impact will be significant, especially for base load units. For example an average CCGT can expect an 11% reduction in spark-spreads in 2015 if the new parameters are introduced. Such a reduction will have a serious impact on a generators' profitability, especially since CCGT plant are relying fully an uplift revenues to make a return.

A reduction in SMP will also decrease the market revenues of generators in receipt of subsidies and will therefore increase the PSO.

2.4 Regulatory Risk

The uplift parameters have remained unchanged since the market began in 2007. Since the SEM will be undergoing significant change in order to comply with European Target Model by 2016, it is important that as much regulatory certainty is retained as possible in the near term.

In addition to this, the design feature of the rules of the T&SC which allow the SEMC to change the uplift parameters, was never foreseen to be able to have such a material impact on market participants. As mentioned earlier, the uplift portion of the SMP has grown significantly. While making changes to technical parameters may have been envisaged as "tweaks" in order to optimise the algorithm, it could now result in pool revenues to generators being decreased by 2%.