



EAI Response to ISEM Draft Decision

SEM-14-045

Electricity Association of Ireland

Markets Committee

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The Electricity Association of Ireland (EAI) is the trade association for the electricity industry on the island of Ireland, including generation, supply and distribution system operators. It is the local member of Eurelectric, the sector association representing the electricity industry at European level.

EAI aims to contribute to the development of a sustainable and competitive electricity market on the island of Ireland. We believe this will be achieved through cost-reflective pricing and a stable investment environment within a framework of best-practice regulatory governance.



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Introduction

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EAI welcomes the opportunity to respond to this consultation. The decision emanating from this consultation will fundamentally determine the future electricity market design (encompassing energy trading arrangements and capacity remuneration) which will have enduring consequences for market participants and consumers on the island of Ireland. It is therefore crucially important that industry is afforded the opportunity to input to the detailed design as any inefficiency and (perceived) risk inherent in the market design will inevitably increase costs to the consumer.

The draft decision paper offers a broad outline of the energy trading arrangements and the capacity remuneration mechanism (CRM) that is proposed to replace the current market design (SEM) at the end of 2016. A plethora of fundamentally important issues and questions are reserved for the detailed design phase which, according to the project plan published in February 2013, is to be completed by February 2015. For example important detail beyond the high level proposal for Reliability Options (ROs) needs to be established such as what type of product bidders will sell in an RO and measures linking the RO to the physical delivery of capacity, which will be necessary if the ROs are to solve the missing money problem and ensure capacity adequacy. More generally the CRM design must be carefully tailored to suit all-island market conditions and, if auction-based, will require appropriate lead times and transitional arrangements.

Equally fundamental to the detailed design phase are: effective measures to promote liquidity in all trading timeframes; the development of a market power mitigation strategy; comprehensive testing of Euphemia and its performance, and the development of real time arrangements for energy trading among other matters. Resolving these issues is not a trivial exercise that can be accelerated.

With the project already about five months behind schedule the detailed design phase is likely to be compressed by a factor of two. EAI therefore strongly urges the SEM Committee to carefully review the original timetable for the ISEM project as published in February 2013 and consider the continued feasibility of this given the magnitude and nature of the work that remains to be completed.

If an extended timetable is necessary it would be advisable to reach such a determination at this stage of the process to facilitate a more considered and consultative detailed design phase. It is essential that an updated project plan is published without delay allocating sufficient time for:

- Robust and inclusive EUPHEMIA testing
- Genuine industry consultation in detailed design
- Participant IT procurement and readiness

The remainder of the EAI response addresses the EU context and the issues of liquidity, balancing market design and capacity remuneration.

Target Model Compliance Timelines

It is now possible that CACM will not be agreed before the end of 2014 which will have a knock on effect on the timeline for agreement of the balancing and forwards network codes. Furthermore, whilst progress has been made in the introduction of a European Day Ahead Market (DAM), the project to introduce a common intraday market (IDM) has been beset by delay and may not be finalised by 2017. This should be considered in the context of ISEM timelines. It would also be prudent for the RAs to consider the need for contingency arrangements to market coupling via Euphemia if testing deems such arrangements necessary.¹ Fall back arrangements for Intraday markets eg SEM-GB intraday coupling pending completion of EU IDM should also be considered in the detailed design. An assessment of the potential for periodic ID auctions should also be carried out. Timelines must allow for a transitory phase for the CRM (based on the current mechanism) so as not to radically undermine existing investments in SEM.

The RAs argue that compliance (with the target model) is a necessary but not sufficient condition of market design and that the ISEM project offers the opportunity to improve on aspects of the current market design. The RAs and market participants have mutual objectives of enhancing incentives for efficient interconnector trading as well as the procurement of energy, capacity and services at an optimum price for the consumer. The market must additionally adequately remunerate and incentivise the provision of energy, capacity and services. In this context, we welcome the commitments to work on improving forwards market liquidity, introduce mandatory balancing participation and the retention of a capacity remuneration mechanism. EAI also welcomes the recognition of the need to remunerate non-energy services.

Detailed Design

The draft decision paper proposes that a number of important issues will be resolved at the detailed design phase. It is imperative that sufficient time and resources be devoted to this important stage of the process. EAI would welcome publication of a detailed scope and updated timelines for the detailed design phase alongside proposals for industry involvement at the earliest opportunity.

Industry expertise will be especially important during the technical detailed design phase and has proven instrumental in the past eg during SEM design and the UK CRM. The draft decision flags important issues such as the suitability of the EUPHEMIA algorithm that will require industry input to test and determine. Such testing should include dynamic modelling of potential generator bidding strategies in ISEM using Euphemia offer formats to provide evidential support for the hypothesis stated in the draft decision that generators will 'learn how to bid to achieve a consistently efficient outcome'. Such modelling should also reveal the extent to which feasible scheduling will result from Euphemia that does not require significant TSO intervention in the dispatch market.

Finally, we urge the RAs to carry out a more robust overall CBA to ensure that the ultimate decisions are in the best interests of the consumer and market participants and deliver against their stated objectives.

¹ Which may for e.g. be through amending the Euphemia algorithm to cater for ISEM specific needs

Liquidity in ISEM

A key objective of the new market design is the creation of a sufficiently liquid forwards market to allow producers and suppliers the opportunity to hedge their day to day commercial risks. The RAs propose exclusive trading in DAM and IDM and financial trading in forwards market only with financial trading rights for the trading of interconnector capacity to improve liquidity in the forwards market. We suggest that the issue of forward liquidity which is heavily influenced by liquidity in subsequent timeframes, be given priority during the detailed design process, and would stress that forward contracting would normally start up to 18-24 months in advance of real time with some retail customers wishing to contract 3 years out. Therefore it is important to get this component of the market working early.

Balancing Market

With regard to the balancing mechanism and the choice between single and dual pricing the decision paper has reached conclusions on this without sufficient robust consideration of the alternatives and their impacts or justification for the choice. The objectives of the BM must be made clear to the market and alternatives for balancing market (and imbalance) pricing should be afforded due consideration. Recent GB experience on this issue is instructive in this regard. While balancing responsibility is required and accepted, a move away from the SEM socialised balancing regime requires due consideration of the alternatives and impacts and be justified for a market of our size.

The high level objective of this part of the market is to incentivise accurate forecasting at the Day Ahead Stage and requires a certain amount of learning by doing in the respective markets. Portfolio bidding should be an option for demand and all variable renewables providers irrespective of size. Finally, the incentivisation of commercial and competitive aggregation should be prioritised over development of a last resort option.

Proposed CRM – Reliability Option

EAI welcomes the proposal to complement the energy trading arrangements with a capacity remuneration mechanism. Greater clarity on the objectives of a CRM in the context of the RAs' stated preference for a reliability option would however be welcome. In order to provide certainty to investors in the intervening period between the phasing out of the current CRM and the introduction of a replacement, EAI proposes that a transition mechanism be progressed with the current regime as the starting point.

EAI is disappointed by the decision to move away from the current capacity mechanism as this has been thought to work well in the current SEM and is well understood. EAI believes that the current approach might still be the appropriate solution for capacity adequacy requirements in SEM. At a high level, EAI believes that the chosen CRM must be physically backed – a financial only mechanism is not conducive to capacity adequacy and opens up potential financial regulation costs. We would further urge the access to the mechanism for importers be contingent on reciprocal access for ISEM market participants in the importers' respective capacity markets.

EAI confines its comments hereafter to the proposed RO mechanism. The experience to date of Reliability Options in markets such as Columbia and New England should inform design

considerations in SEM. ISO-NE is currently undertaking significant change to the “capacity product” under its CRM after its quantity based mechanism proved to be inadequate, resulting in ‘boom-bust’ prices and under capacity after its introduction four years ago. Under the changes it is proposed to replace the Installed capacity requirement with a sloped demand curve and reference it’s the Costs of a New Entrant(CONE) against a CCGT from a. On top of the Capacity Base Payment market participants will now receive a Capacity Performance Payment (or penalty) for delivering on their obligation. These are just some examples of the many issues involved in designing an RO and without an insight into the detail it is difficult to assess how effective an RO may be in delivering against our stated objectives for a CPM.

Conclusion

The detailed design process will determine the compatibility between the HLD and some of the underlying assumptions/objectives. It is imperative that the detailed design phase (and consequently the ISEM timetable) is not overly compressed. The technical and commercial expertise of industry will be a crucial input to a design which delivers on its objectives. In this response we have highlighted a number of the key issues of process and substance for industry on the island. We would welcome further opportunity for discussion of the issues highlighted this response and publication of the detailed design scope at the earliest opportunity.

Electricity Association of Ireland, 25th of July 2014