

Energy Trading Arrangements Detailed Design

“Building Blocks” Workshop Topics

Power NI Comments

26 November 2014

Introduction

Power NI welcomes the opportunity to submit comments on the “building blocks” of the ISEM Energy Trading Arrangements (ETA) as the Regulatory Authorities (RAs) consider feedback provided at the recent workshops and begin the formal consultation phase.

As the RAs are aware, Power NI is the largest electricity retailer in Northern Ireland. Power NI is part of the Viridian Group which has within in its portfolio a retail position in Northern Ireland and the Republic of Ireland, as well as a significant thermal and renewable generation presence.

Power NI is however a separate business. Power NI’s legal, managerial and operational separation is mandated via licence condition and it is within the context of being a supplier without vertical integration; that Power NI has approached the ETA workshops, assessed the issues presented and now comments in advance of the ETA Consultation Paper.

General Comments

Prior to responding in relation to the specific topics Power NI has a number of general comments in relation to themes which cut across the entire ETA determination.

Timetable

Despite the working assumption that the target implementation date is Quarter 4 2017, this deadline remains a significant challenge for the RAs and market participants. Power NI welcomes the RA’s commitment to engagement and the publication of project plans is fully committed to engaging constructively with the RAs throughout the detailed design process.

The RAs should remain cognisant however that despite the presumed extension, the project remains on a critical path and contains little contingency. Such time pressure has required a number of interdependent workstreams to be scheduled in parallel. This can create a silo approach to design which, without adequate consideration of the interdependencies, risks unintended consequences and a sub-optimal design.

Additionally, compressed timetables have in previous major market projects, led to a shortening of the design phase and a reduction in the implementation and testing phases. This represents a significant risk to the market and its participants.

During workshop 1.3 there was a suggestion made by a participant that the consultation periods should be shortened. Power NI does not support this proposal and would welcome the RAs extending the proposed consultation response period from 6 to 8 weeks, enabling greater levels of consideration and engagement.

As stated above, the working assumption communicated to participants is that ISEM will go live in Q4 2017. Power NI would welcome the RAs confirming that the relevant Departments have accepted the movement from the original target date and whether any further contingency movement is possible.

Process

The discussions at the RLG meeting have highlighted that attempting to consider the presented “building blocks” is difficult without a broader understanding of the new markets.

As the discussion turns to the market arrangements, further comment and detail impacting the building blocks may come to light. Mindful of this, the RAs should consider merging the building blocks and markets consultation into a larger holistic paper which would provoke more in depth responses from industry.

Within the information papers published to date the working examples have provided a useful context and explanation. Power NI would welcome the RAs continuing to publish such examples both in future information papers and any consultations.

When considering the Detailed Design of the ETA, the RAs have clearly stated an intention to, wherever possible, transfer existing policy decisions from SEM to ISEM. This has been a theme of a number of the detailed discussion points and Power NI, cognisant of the RA position, has not sought to reopen or comment upon policy decisions made by the RAs which affect the “building blocks” below. Lack of comment on existing policy decisions by Power NI should be read in this context.

Although linked to a different workstream, it would be remiss of Power NI not to urge the RAs to bring forward the planned work on the Forwards Market and Liquidity. A functioning forwards market is essential for Suppliers and lessons must be learnt from SEM i.e. a forwards market will not naturally evolve. In order to have adequate hedges in place for the ISEM market, forward market hedges will need to be available a minimum of one year before the go live of ISEM. This brings the timetable for the establishment of a properly functioning market forward significantly. Power NI would therefore welcome the RAs recognising the urgency in relation to this issue and expediting the initiation of that particular workstream.

Clarification on the role of SEMO is important

The role of SEMO was a theme which cut across a number of the topics discussed. Central Counter Party, Clearing House, Single Point of Registration, NEMO and Shipper were all roles described, as the building blocks were discussed in relation to the High Level Design. While the RAs have stated that the Network Codes will define the extent which these services should be competitively tendered for, it is difficult to imagine, in an ISEM context, how appointing SEMO to all roles on a price controlled basis would not bring implementation and operational efficiencies.

Power NI would welcome the RAs lobbying at a European level, wherever possible, for the option to appoint a single counterparty for all roles.

EUPHEMIA

The use of EUPHEMIA is a critical component of the market design and Power NI welcomes the transparent approach SEMO have proposed with respect to testing. It is important that transparency prevails throughout the whole process from establishment of initial testing by SEM in isolation scenarios, through to test plans and results from coupled market scenarios. Timely publication and full transparency of data prior to any workshops will allow market participants to complete their own analysis and feed back into the process prior to any re-run of tests.

Alongside facilitating efficient scheduling and pricing in the day-ahead market, prices from EUPHEMIA are also likely to become an important reference in the forwards market. Costs or benefits associated with the forwards market will ultimately be feedback to end customers, making it essential that EUPHEMIA is optimally implemented in the development of I-SEM.

Power NI will, as requested respond directly to SEMO re EUPHEMIA testing and participate in the market testing. The RAs should however remain cognisant of progress in relation to EUPHEMIA, request regular updates, insist on checkpoints in the project plan and review the results of testing.

Workshop Topics

Losses

The implementation and treatment of losses should be as clear, automated and reflective of the physical network as possible. From a supplier perspective the

extent that the losses are not reflective of the physical reality ultimately creates error which will be seen in Balancing Market exposure.

Suppliers accept some level of risk in this area and this will be factored into forecasting, hedging and positions taken in earlier markets. To assist this, clarity of approach is fundamental.

Firm Access

A Suppliers comments in relation to firm access is limited. It is important however that the treatment of firm access does not lead to dysfunctional outcomes in the Balancing Market.

Constraints

Discussion of constraints is severely limited without a full understanding of “flagging and tagging”. Network constraints are inevitable due to the nature of the transmission network in the ISEM. Actions taken by the TSOs to balance the market outcome with the physical requirements must be clearly understood, defined and accounted for.

From the perspective of a Supplier, it is imperative that constraint costs are accurately tagged and therefore do not appear in the price signals of the balancing market. Constraint costs are socialised in the current SEM; Power NI believe this principle should transfer to the ISEM. Allowing the costs to appear as energy balancing actions in the pricing setting of the balancing market does not socialise constraint costs but creates balancing market risk for Suppliers who have an inherently variable demand and are exposed to error volumes. This would disproportionately push constraint costs to domestic customers.

Priority Dispatch

Priority dispatch is enshrined in legislation. The facilitation of this requirement within ISEM therefore is purely an implementation question. Power NI believes that the realisation of this legislative requirement should not adversely impact the implementation of a properly functioning, cost reflective balancing market.

Similar to the constraints considerations, allowing a policy cost to appear as an energy balancing action in the pricing setting of the balancing market does not socialise the cost but creates balancing market risk for Suppliers who have an inherently variable demand and are exposed to error volumes.

The RAs should also carefully consider the commercial behaviour likely to result due to the running guarantee given by priority dispatch and ensure that constraints are minimised and variable generation has a requirement to ensure that a properly functioning forwards market develops.

Curtailment

From a Supplier perspective the curtailment of lower cost generation should be minimised wherever possible.

De-Minimis Level

The current de-minimis level affords developers a choice in their route to market. For small developments which are part of a wider portfolio the current SEM has advantages; for independent developers who wish to avoid participation costs, contracts with Suppliers are available. This choice facilitates diversity in the range of generation developments and removes the barrier to entry which participation would be for small developers. The contracts are also critical in enabling the development to secure the necessary finance.

Power NI believes that the current policy has facilitated the dual goals of generation entry and renewable development. Given the RAs stated position in relation to current policies, Power NI can see no reason why this policy decision would also not transfer to ISEM.

When the RAs are considering aggregation services, it is important to recognise that for small scale developments which avail of the de-minimis threshold, Suppliers provide an aggregation service. Suppliers provide contracts, a route to market and assume the associated volume and forecasting risk. In many cases it is the contract and financial strength of the Supplier which facilitates the financing of the development.

Finance providers will look to the counterparty and proposed contract before providing the development funds. This may not be available under other arrangements and therefore may adversely impact a developer's ability to secure finance and ultimately the pipeline of new generation. This would be a significant detrimental unintended consequence should the RAs change the de-minimis level.

The current treatment of de-minimis reflects the physical reality of local embedded generation meeting local demand and reducing larger scale generation requirements. An artificial change to treat de-minimis as negative demand, divorced from a corresponding customer base; distorts the principle of local generation reducing local demand and would introduce a discriminatory two tier generation pricing regime. In addition, it would no longer reflect the physical reality and could potentially be troublesome or even incompatible with EUPHEMIA. "Aggregation Services" therefore should only be considered in relation to participating renewables.

Currency

The principle of dual currency was a fundamental building block of the SEM. Power NI believes that to not continue with the dual currency arrangements

pushes cost to Northern Irish generation, supply and ultimately customers. In the context of a single island market it could also be viewed as discriminatory.

From discussions at Workshop 1.3 it appeared that no participant was advocating a removal of the dual currency policy. Power NI believes it should be maintained and is a regulatory principle which should transfer from SEM to ISEM.

In terms of the implementation methodology, Power NI believes lessons can be learned from SEM. The SEM implementation was correct in absolute terms. It was however extremely complex to implement, volatile, subject to a number of audit recommendations and entirely non transparent. Treating currency akin to a Market Operator or Imperfections Charge, socialises the cost and provides the transparency and stability which participants require. Including it in a regulatory approved tariff also facilitates regulatory scrutiny.

Power NI would not support an “up front fund” to cover currency costs due to the working capital implications. It could also be considered as a barrier to entry.

Participant Registration

As discussed at Workshop 1.3 there appeared to be market consensus that the ideal registration process should be as simple, straight forward, flexible and expedient as possible.

To achieve such a desired outcome it is difficult to envisage anything other than a single point of registration. This point is linked to the earlier discussion and the role of SEMO in the ISEM.

The concept of intermediary registration should also be maintained.

Clearing & Settlement

To a certain extent the settlement of the Day Ahead and Intra-Day markets will be driven by coupling arrangements. In general terms however, Suppliers strong preference is for longer payment terms. This assists in managing the significant working capital requirements the wholesale market creates. The resultant reduction in credit exposure from any shortened payment terms is not a like for like balance.

In determining the settlement processes, one central clearing body operating across all markets (including forwards & capacity) would facilitate the necessary netting arrangements which must be retained. The current SEM affords a settlement reallocation process which acts to reduce unnecessary working capital and credit exposure. This reduces participation costs and therefore ultimately cost to consumers. While the current settlement reallocation process may not naturally be able to transfer the principle should endure. A contractual arrangement to reallocate a percentage for example, may be a workable alternative.

Credit Risk Requirements

The current SEM principle in relation to credit cover is that the market should be fully collateralised. While this is a principle that participants supported, the implementation has resulted in a significantly over collateralised market. Power NI urges the RAs to consider all options to reduce the burden of collateral which is placed upon participants. This should include consideration of the forward market collateral requirements. A holistic approach to exposure, including provisions for netting or general reduction should be considered wherever possible. The RAs should also consider collateral options such as Parent Company Guarantees and insurances as alternatives to the cash or Letter of Credit approaches. Such options may provide a lower cost alternative while still providing the desired cover.

VAT

As discussed at Workshop 1.3 Power NI would strongly advise the RAs to begin discussions with the relevant VAT authorities as soon as possible. The equivalent discussions in advance of SEM go-live were left until relatively late in the process and resulted in a workaround solution being implemented and subsequent changes made.

All participants are cognisant of the absolute requirement to be VAT compliant. Achieving such compliance can only be achieved through the RAs engaging with the VAT authorities, securing clarity on requirements and ratification of implementation decisions.

Shipper (financial)

Further detail will be required in relation to this concept however the role of SEMO and ultimately the Central Counterparty will clarify if this is a requirement.

Market Information

Power NI welcomes the RAs intention to publish as much information as possible. At this stage it is not possible to comment in detail re the timing or content of such information.