

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

SEM

**Discussion Paper and call for Evidence
on Scarcity Pricing and Demand Response
in the SEM**

**SEM-21-042
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Response by Power NI Energy (PPB)

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Introduction

PPB welcomes the opportunity to comment on the SEM Committee's discussion paper and call for evidence on Scarcity Pricing and Demand Response in the SEM.

PPB's primary objection to changes to the Administered Scarcity Pricing (ASP) arrangements is that it would greatly increase the risk exposure under pre-committed Reliability Option (RO) contracts when those contracts were entered into and ultimately priced based on the ASP regime that was defined under the Trading and Settlement Code and included in the Final Auction Information Pack (FAIP) for the relevant capacity auction. An amendment that increases the risk under RO contracts will be seen as regulatory risk in the SEM and will serve to deter investment and/or increase the cost of capital for investment in the SEM that will ultimately increase costs for customers.

The measures proposed also only serve to increase exposures for existing participants when the failings have largely been due to TSO decisions on, for example, the Capacity Requirement, de-rating factors for DSUs etc, all of which have created the concerns over security of supply next winter. These wider failings should be the focus of attention rather than seeking to move the goalposts for existing participants who are already well incentivised to deliver on the commitments.

Notwithstanding the above concerns/objections, the proposals themselves will not achieve their desired impact in respect of concerns over the forecast tight capacity margins in terms of greater generator availability and we are similarly sceptical in relation to demand response.

Detailed Comments

Wholesale Prices in the SEM

It is no surprise that prices have rarely exceeded the RO Strike Price and ASP has not yet been triggered in the market. Commodity prices have been relatively low over the last 18 months, only increasing in the last six months. Given the capacity margin, the system would need to be very stretched before we would expect to see significant scarcity premiums in the Ex-Ante markets albeit there will be a strong linkage to the BM price expectations.

BM prices are strongly influenced by Complex bids that will apply to units with no ex-ante position and which must comply with the Bidding Code of Practice. No scarcity premium can be included in these prices and hence BM prices will regularly be based on production costs of generating units and with relatively low commodity prices it is no surprise that only a few generating units have production costs that exceed the RO strike price (and this was part of the design).

ASP has not been triggered because the reserve margins have not been encroached to date and the analysis presented in the paper in respect of system alerts provides evidence of this fact.

All of these outcomes are coherent and as would be expected from the market, operating rationally and efficiently.

Generation adequacy in SEM

Forced outage (FO) rates may have been higher than the TSOs and RAs forecast but are not unexpected to most market participants. PPB has consistently argued that given the increasingly stressful running regimes on conventional units, as their load factors reduce and units are stopping and starting much more regularly, that FO rates will inevitably increase. We have previously objected to the TSOs and SEMC's use of low FO rates in their determination of the capacity requirement and BNE both in the I-SEM and SEM before it. Freak events can occur that cause prolonged outages and it is just a fact that "averages" of availability do not account for when applied in probabilistic analysis when conducting generation adequacy assessments. Hence there will be a distribution across time where FO rates will be both below and above the long run average. The impact of co-incident events that, although rare in probabilistic terms, do happen is compounded in Ireland by the relatively large generating unit size relative to peak demand.

The other significant failure is that the capacity requirement is determined based on an 8 hour loss of load when the actual statutory standard is higher, and while policy makers and the TSOs actually want a zero hour standard (i.e to never have a generation shortfall).

These all highlight that the main failing has been that not enough capacity was secured in the auctions and seeking to retrospectively penalise capacity that secured contracts will not do anything to address that failure.

System Alerts and Reserve Scarcity Pricing (RSP)

The existing arrangements are coherent and there is no need to make any changes for the trigger for Reserve Scarcity Pricing (RSP). There is only an actual scarcity and high risk if reserve is eroded to maintain supply to customers and the analysis presented in the paper clearly identifies that this has not been the case with the system alerts to date. Alerts provide advance warning, usually that there is a risk that this could happen but that usually requires a further event to occur for that to materialise. Hence such an alert allows participants (particularly demand since it is rare that a generator can suddenly reinstate capacity from an outage) to react on the basis that there is a possibility of very high prices should that risk materialise, thereby increasing the buffer and reducing the risk of being unable to meet demand and maintain reserve levels.

As already noted above, any change to the RSP trigger or FASP would increase the exposure under the RO contracts for existing participants, yet for generators they will have no additional scope to manage or mitigate the risk and hence such a change would undermine contracts already entered into. Such a change will be seen as Regulatory Risk and will impact on the prices in the market in future for both existing capacity and at a minimum on the cost of capital for new investment, while also generally making it much more difficult to attract investment into the SEM.

If such changes to the RSP were to be made then they must be signalled as part of the auction parameters and only apply to those contracts since the potential capacity providers will have the ability to appropriately reflect the modified exposure risk in their auction bids.

Generators already have significant exposure under the RO difference payments and in our experience, generators will do everything in their power to be available if at all possible to minimise their exposure. Hence any change to the RSP/FASP arrangements either to the price profile or the trigger points will not change the behaviour of generators beyond what they do today. The only outcome would be to increase the financial exposure of generators but as we have already noted, any such change will only serve to penalise existing generators in the short term but customers will ultimately bear a greater cost in the longer term. None of these actions will assist in addressing any capacity shortfall and security of supply concerns for the upcoming winter.

Demand Response

In section 3.1 the SEMC suggests that Suppliers could benefit from being long in the ex-ante markets and selling the surplus in the Balancing Market (BM). However, such a trading strategy would conflict with the Supplier's balance responsibility obligations.

The SEMC asks whether short-term incentives could be introduced to incentivise DSU availability. Any such incentives must not distort the market as one MW of capacity should have equal value when available at any given time and there must be no two-tier arrangements created that distort normal market functioning.

Advance Notification prior to Amber Alerts

PPB agrees that the more notice participants are given then the scope for assistance may be greater although, as noted above, this is unlikely to have any effect for conventional generators but may assist DSU activity. There is already a high level of information available through REMIT reporting obligations and any information publication will clearly need to be compliant with insider information obligations etc.

Conclusions

Generators are already exposed to significant costs under their RO payment obligations should they be unavailable and hence are already highly sensitive to this exposure during outages. Generating units do fail at times and the increasingly stop/start nature of operation in a high RES market only increases that risk. The exposure means that generators already do everything in their power to return to full availability and changing the RSP pricing levels or triggers will have no impact on generator behaviour and hence will not improve the outlook for security of supply this coming winter.

The main issue is the failure of the TSOs to secure sufficient capacity through consistent under-estimation of the capacity requirement and the closure signals that have provided to generators over the last few years. It is this failing that needs to be addressed rather than seeking to apply further penalties to generators who are already doing all they can to manage their risks, particularly where the result of such regulatory intervention will be to either deter needed investment in the SEM or at best increase the cost of capital for such investments.