

21/07/2021

Subject: SEM 21-042 Discussion paper on scarcity pricing and demand response

TO: Gina Kelly (gkelly@cru.ie) and Kevin Barron (kevin.barron@uregni.gov.uk)

Dear Gina and Kevin,

We are writing to you to convey our response to your discussion paper on proposed changes to administered scarcity pricing for the forthcoming winter period.

Response to dispatchable generation capacity shortfall

In line with previous correspondence with the Regulatory authorities we have expressed our concerns about the imminent generation capacity shortfall in the ISEM. We believe that several hundred MW of (at least) MidMerit gas fired generation is required both in the near term to manage this capacity risk, but also over longer timeframes to support our low Carbon transition as older existing plant retire and more flexibility is required.

Notwithstanding the unfortunate concurrent forced outage of two CCGT, ultimately the problem arises from a failure to properly plan for Demand increases and generation capacity retirements. Whilst we acknowledge a solution is needed in the short term it is important that subsequent capacity auctions adequately incentivise the construction of suitable new capacity.

In the short term for this winter and presumably up until the point of new capacity delivery, assuming that existing demand is relatively firm, we would comment that if a generation capacity shortfall exists then that can only be rectified adequately by new dispatchable generation capacity, whether on an enduring or emergency basis. It would appear to be the case according to recent news reports that emergency generation has been procured already. It would be useful for the industry as a whole to understand how these contracts will be remunerated and what their impact will be on market prices and positions as soon as possible and through regular channels rather than through the news media.

Dispatch of DSU in the market

With regards to this paper, the general intent appears to be to incentivise increased demand response by increasing the price applicable in the balancing market, presumably up to a point where a DSU would be dispatched. The appropriate consideration in this regard is not whether the market price is high enough to dispatch a DSU but more a question of whether DSUs price



themselves in a way in which they will be rarely ever be called to run. We believe that a certain cohort of DSUs who provide response by consuming less energy are pricing themselves relative to both the cost of interrupting their process *and* the risk of being dispatched. If scarcity pricing is invoked and the risk of the DSU being dispatched increases then we believe those DSUs will simply increase their price in order to maintain the same relative risk. This will result in the proposed changes not having the desired impact.

We would further comment that the widespread use of DSUs as a security of supply tool has never been tested at a system wide level and that it would be dangerous from a system security point of view to rely on an untested response this winter. If there was to be widespread dispatch of DSU it would likely incur extra costs on those providing this service which may result in losses for those participating.

Relationship between system alerts and pricing

With regards to the link between system alerts and pricing, it is worthwhile considering the reasons for system alerts and whether they should trigger system wide price changes in the ISEM. We believe we should not lose sight of the fact that the RO strike price at €500/MWh, is still a very large number which historically in the SEM and ISEM has rarely been reached despite numerous combinations of different capacity situations and fuel prices. We believe that this is appropriate pricing action for the market.

The majority of system alerts have been jurisdictional, and many in Northern Ireland have been due to a system constraint in the ISEM where insufficient power transfer capacity exists between the Republic of Ireland and Northern Ireland. We do not believe it would be appropriate to impose a system wide price change to a localised constraint. Such an action would only be appropriate in a Locational Marginal Priced based market. Transmission reinforcement is the only solution to such an issue.

The fewer number of system alerts that have been all Island in nature are driven by security of supply issues in general, however these are exasperated by issues relating to Brexit and pricing of interconnector flows. This winter the ISEM needs to import power from GB. However GB is also expected to experience system tightness. Prior to Brexit with Britain and Europe coupled the price of this tightness would be shared across Europe and minimised by interconnector flows. In the new arrangements post Brexit with GB decoupled and its Day ahead market liquidity split in two, prices have reached extremely high levels in excess of €1,000/MWh frequently. It is expected that this pricing action will be seen again this winter. The presence of the RO strike price in the ISEM has helped cap some of this downside for ISEM consumers. The combination of far higher GB prices post Brexit with the necessary protection of the RO strike price for ISEM consumers has resulted in the situation where exports now flow to GB where prior to Brexit we would have seen imports to ISEM. These export flows have and will drive alert situations in the ISEM. It would be unfair to change the market

conditions in ISEM in order to mitigate events driven by structural changes brought about by another country's actions.

Impact of scarcity pricing changes on consumer costs

If scarcity pricing were to be invoked earlier in the price curve we would have serious concerns about consumer welfare. If the nature of price risk for a non performing generator was to increase in line with scarcity pricing in the balancing market, then the natural mitigation for this risk would be to for the Day ahead market price to rise. Such an outcome would be detrimental for the end consumer who is already facing significant cost rises due to the capacity tightness.

Conclusion

Any measures introduced to bring more demand response into the market cannot be introduced in such a short period but should be considered over longer time frames. We would suggest that the triad mechanism in GB should be considered as an alternate option which brings about a 2GW reduction in peak demand in GB on the tightest capacity days. Prorating for ISEM demand would deliver about a 200 MW peak reduction.

In summary, with the exception of providing more notice of system tightness events, we are not in favour of the changes proposed in this paper. The security of supply situation in ISEM requires additional dispatchable generation capacity, and improvements to post Brexit market coupling in the region.

We are available to provide further information if required.

Best Regards,

Colm mac Oireachtaigh
Head of Forward Trading.