21st of July 2021

**RE: EAI response to SEMC Discussion Paper and Call for Evidence on Scarcity Pricing and Demand Response in SEM(SEM-21-042)**

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

Dear Gina and Kevin,

EAI members welcome the opportunity to engage in this public consultation.

At the outset, we think it is important to note ongoing concern in relation to Security of Supply (SOS), understood as both energy and system security, that EAI members provide energy, capacity and services to the system, and for the purposes of this consultation that Scarcity Pricing in SEM is understood to be defined relative to system scarcity, i.e., triggered when reserve requirements are exhausted, or load shedding becomes necessary.

We understand that SOS concern, and incidences to date where the price has not reflected underlying system scarcity, has prompted the RAs to reflect on the function of administered scarcity pricing in SEM. Specifically, the RAs are considering adjusting the trigger for the Administrative Scarcity Price (ASP) in an effort to provide a signal for the market to respond to the ongoing tightness in the system.

Our members have raised significant concerns with the proposals that are proposed to be implemented for an interim period to address expected tight margins for Winter 2021/22. We also expect that a complementary response will be submitted by the DSU community, outlining some parallel concerns they have with the proposals.

We are of the view that it is flawed to align scarcity pricing mechanism to system alerts, that it will not solve the underlying concern intended and that it will have further negative impacts on the market at large. We are further concerned that this is signalled as an interim measure but with no end deadline. This introduces additional uncertainty and increases regulatory risk for industry, before it has even been considered whether the proposals are suitable market interventions to meet the specific intent.

In our view, a longer lead time needs to be considered such that only future capacity contracts are affected, rather than existing and active contracts. More importantly, we would consider that the current issues outlined in the paper are as a direct result of underestimation of capacity requirements for successive capacity auctions, as well as a withholding of capacity given uncertain demand (which we are seeing cannot be realistic where we now have issues of connecting data centres).

As part of its ongoing review of VOLL, the RAs are also considering the EU request to bring the Full ASP in line with VOLL, so that the price of scarcity in the energy market is the same as in the capacity market[1]. It would be our view that the proposals on ASP contained in this paper, should be considered holistically in the expected review of VOLL by the RAs.

We also agree that the proposals will need to carefully consider EBGL requirements.

**Background to the Scarcity Pricing proposals**

We appreciate that at present we are facing a likely period of system tightness in Winter 2021/22, which needs to be addressed to ensure security of supply. Our understanding of this paper is that there is an assumption that potentially higher cash-out prices (through referencing the RSP curve to the RO strike price) will increase responsiveness of demand side response, which should hopefully align with times of scarcity. There is also a consideration of whether the short-term reserve approach should be adjusted and whether in the context of market responsiveness, advanced notification of system events would be useful.

We note that since the publication of this Call for Evidence the media has reported that ~200MW of generation capacity has been procured for Winter 2021/22. Our understanding is this will go some way towards alleviating the concerns addressed in this Call for Evidence. Whether further measures are now required on an interim basis on top of this Winter contract is unclear. We would welcome more transparency on perceived security of supply threats this Winter even with this 200MW Winter capacity, to better understand impacts on the market and importantly, if further interim measures need to be taken. Any further interim measures taken, akin to those proposed in this paper, should not impact investor confidence at a time when the need for market-based procurement of capacity is widely accepted.

**Problems with proposals for ASP**

The premise on which the proposals are based, that the ASP is not working as expected, is flawed. The ASP is a trigger to mitigate against significant system issues and is triggered when we are close to exhausting our reserve requirements (or when load shedding becomes necessary). ASP is logically linked to a possible Red Alert scenario currently, which is prudent. It is also a scenario that is by its construction, designed to be rare.

System alerts in the SEM have not related to supply scarcity and have therefore not triggered a scarcity price response. We can see in the analysis in the appendix that to date there have been no scenarios where an ASP should have been triggered. We have never reached the level of exhausting our reserve requirement. The intent of the paper is to link RSP (which is triggered when we have exhausted our short-term reserve requirement), specifically closer in line with parameters that govern Amber Alerts. The RO strike price is currently triggered usually at the level that an Amber Alert is called. The market has experienced frequent Amber alerts with subsequent RO prices being triggered. This frequency we can only assume will continue and potentially increase through the Winter 2021/2022. It would be illogical to lower the RSP to such a frequent trigger at the point of Amber Alerts, which is designed to

[1] The latter parameter it is worth noting, is used only for determining the volume of capacities procured and so has only relatively benign impact on financial exposure for participants, in contrast to the impact of the EU's request

bring on more capacity, rather than address the situation of reserve shortfall or load shedding. This would also appear a disproportionate step that would undermine the intended effect of the ASP, even if it were an interim arrangement.

It should be recognised that the capacity market is designed to meet an 8-hour security standard, not to prevent Amber Alerts, and that the SEM is an unconstrained energy market designed to efficiently allocate risk and provide the necessary price signals to invest in grid and system operations where required.

The RAs are effectively confirming that frequent non-scarcity events will carry with them much higher penalties for generators under the current proposal. It is inappropriate to consider lowering the trigger for the ASP without further clarity on why alerts are being called at times when there is no scarcity. Moreover, we have not been provided with information to say that existing capacity is not responding during Amber Alerts. Effectively the lack of existing capacity in terms of MWs being there to offer a response is more the issue. Signals to invest in capacity would help alleviate the RAs' concerns. In addition, linking ASP to Amber Alerts could trigger higher prices even when there is large capacity surplus, and removing Replacement Reserve from the calculation could give rise to ASP pricing caused by TSO scheduling and operational decisions. This will likely feed into higher customer bills as the RO design provides no hedge up to the strike price and beyond that there is a so-called 'hole in the hedge' that the RAs have consistently raised concerns about.

Finally, it should be remembered that the ASP is a significant value in the Final Auction Information Pack (FAIP) for capacity contracts set to date and it has an impact on the overall bid and business case for participants competing in a capacity auction. To change this value for an interim period, part-way through capacity contract terms, is therefore also inappropriate and introduces retrospective risk. The ASP was set at its current level given that there is currently no method to mitigate additional risk, i.e., secondary trading is not clearly and fully implemented in the market. If the ASP were to be amended as suggested, i.e., an adjustment to the RSP curve, this would introduce unfair additional risk on capacity contract holders (whose contracts have already been set up to a specific period in the future). This risk does not have any accompanying mechanism to mitigate it, i.e., a working secondary trade mechanism. Therefore, this proposal will unfairly impact capacity contract holders if they are unable to meet the requirement, when for instance they are on outage, or if they are in the wrong jurisdiction relative to the system tightness and in addition would undermine investor confidence, deterring future investment and raise the cost of capital.

In our view, the outcome of this adjustment to RSP would likely generate scarcity prices based on localised risks which would be inappropriate, and which are not reflected in capacity auction clearing prices.

**Problems with correlation of DSR and ASP**

Considering the other aspect of the paper, it is clear that the intended outcome in adjusting the trigger for RSP, is greater demand side response during times of scarcity. We consider that this is not a guaranteed, substantiated or certain outcome. The current high (and negative) prices have not been matched with changing behaviour from some DSR. It is unlikely therefore that this alternative measure will encourage DSU availability to improve significantly, especially by sharpening the penalty for being unavailable after contracts with customers have been struck. Furthermore, the impacts to all capacity contract holders (including DSR) of this change, as discussed above, is a disproportionate effect of this proposal.

We note that the intention of the paper's proposals is centred around addressing the expected security of supply risk this winter, with DSR response. We consider that DSR has been untested as a mechanism to mitigate security of supply. We appreciate that all angles are being explored given the severity of the forthcoming situation. An untested mechanism for mitigating of security of supply and (essentially), delivery of reduced load, is not a suitable approach to the issue, especially where there is no evidence of outcome.

Finally, we consider that the RAs have focussed on a single lever and discounted the fact that there are other considerations that heavily influence whether a unit offers capacity during time periods at scarcity prices. Where a party is responsive to price signals but is not dispatched, there are still costs that will be levied such as RO exposure and recoverable make whole payments. These are considerable financial risks that are already taken on by RO contract holders and by design ensure reliability which is regularly required during Amber Alerts. The financial implications of not responding to the RO trigger are high. We do not see that changes to the ASP would enhance responsiveness, rather it raises issues of regulatory uncertainty with capacity market design undermining investor confidence at a time when new investments are required in SEM.

**Advanced notice prior to Amber Alerts**

The paper asks for feedback on whether there would be merit in greater advanced notice of system issues. EAI would support advance notice and some of its members have been requesting this recently of the TSO, in response to RO strike price events being triggered by cross-zonal trading actions.

- Notionally, advanced notice does provide useful signals to market participants which can allow units to be more responsive to changing circumstances ahead of time.
- Therefore, EAI would be in favour of this specific proposal in the paper, however for clarity, the provision of such information does not provide justification to support the implementation of the proposals in the paper

**Conclusion**

The main intent of this paper seems to be to create interim signals that will ensure better responsiveness from demand side response during times of scarcity. Above we have addressed why we do not believe such an outcome would materialise on foot of making the proposed changes to the ASP. In brief, EAI believes that the proposed changes would have a knock-on negative impact on investor confidence at a time when, in our tight security of supply situation, we need a large amount of new investment in SEM over the next three years. EAI asks that, since the 200MW Winter capacity contract was announced after the publication of this call for evidence, the regulators provide the market with a clearer picture of the extent of the issue they are trying to address for this winter. The scope of the remaining issue will better inform appropriate solutions that have minimal impact on existing and possible future investments. If the matter is a lack of delivery by existing capacity, that may largely be down to a lack of MWs in the ground or inefficient exit, compounded by these proposals. EAI would like to note that we believe that performance is already effectively incentivised and penalised for the majority of market participants, however if the RA's have evidence of a lack of responsiveness from specific units or unit types that they believe should be responding, other measures should be considered within existing performance metrics.

Yours sincerely,

Stephen Douglas

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